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REVENUE INCREASE OPTIONS

HEARINGS

BEFORE THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDREDTH CONGRESS

FIRST SESSION

JULY 7, 8, 9, AND 15, 1987

Part 2 of 3

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(Similar letters were also received from the following Trustees of the Art Institute of Chicago: Warren L. Batts, Premark International; H. Laurence Fuller, Amoco Corporation; Charles A. Meyer, Chicago, Ill. [also for the Children's Memorial Medical Center, Cradle Society of Evanston, and Lake Forest College]; Edward Byron Smith, Northern Trust Company; and Elizabeth B. Tieken, Chicago, Ill. [also for the Field Museum]).

(Similar letters were also received on behalf of the Chicago Academy of Sciences: Allan E. Bulley, Jr., Bulley & Andrews; John H. Cynkar, Coopers & Lybrand; and Christopher Dunn, Chicago, Ill.).

(Similar letters were also received on behalf of the John G. Shedd Aquarium of Chicago: William J. Cullerton, The Cullerton Company; Benjamin F. Lenhardt, Jr., First National Bank of Chicago; Robert D. Krebs, Chicago, Ill.; J. Donald Higgis, Harris Bank; John Shedd Schweppe, M.D., Chicago, Ill.; and D. Gideon Searle, The Serafin Group).

(Similar letters were also received on behalf of the Lyric Opera of Chicago: Edward Byron Smith, Northern Trust Company; and Louise Smith, Northern Trust Company).

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  (Similar letters were also received on behalf of the John G. Shedd Aquarium of Chicago: William J. Cullerton, The Cullerton Company; Benjamin F. Lenhardt, Jr., First National Bank of Chicago; Robert D. Krebs, Chicago, Ill.; J. Donald Higgis, Harris Bank; John Shedd Schweppe, M.D., Chicago, Ill.; and D. Gideon Searle, The Serafin Group).
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REVENUE INCREASE OPTIONS

WEDNESDAY, JULY 15, 1987

House of Representatives,
Committee on Ways and Means,
Washington, DC.

The committee met, pursuant to notice, at 11:34 a.m., in room 1100, Longworth House Office Building, Hon. Frank J. Guarini presiding.

Mr. Guarini. We'll begin the proceedings.

Today is the fourth and final day of the testimony concerning possible revenue options in order to meet this committee's obligations under the recently passed budget resolution.

Today we will hear from many Members of Congress, and I might say more Members have asked to appear here today than any other time that I've been here in 9 years so that they have very deep and strong convictions.

Some have voted for the budget; some have voted against the budget. I guess those who voted against the budget might have somewhat of an easier time. We have had many possibilities that we've discussed over the last 3 days, and they've run the whole gamut from Social Security taxes, taxes on advertising, revisiting tax reforms, estate taxes, luxury taxes, rate freezes, and surtaxes, tightening up compliance.

I want to welcome you all here. I have a statement of my own that I am going to ask if the staff will put into the record.

[The statement of Mr. Guarini follows:]

Statement of Hon. Frank J. Guarini

Mr. Chairman, in the next few weeks, the Ways and Means Committee will undertake the difficult challenge of raising $19.3 billion in revenues for fiscal year 1988, $65 billion over the next 3 years.

Revenue raising may well be the most responsible position to take but it's never popular. I don't think that any of us relish the task that lies ahead. However, we must make these tough decisions. We voted for the budget resolution and we must follow through on the revenue side. In addition, our constituents, the American people, are counting on our leadership to resolve our deficit problem.

What are our options? Last week, I sat through several days of hearings on revenue raising options. For the most part, the witnesses told us what they didn't want. Some suggested closing more loopholes. We did plenty of that in last year's tax bill, but most of the easy hits have been taken. And there's sentiment in some quarters to go back and undo some of those so-called easy changes.

There's also talk about improving compliance but, as I have learned, some of our colleagues view this as just so much smoke and mirrors. And while compliance can certainly be improved, it takes time to implement—hiring and training staff and conducting the audits and examinations, for instance, before the results are actually seen.

At the beginning of this year, I was appointed to the Budget Committee. Early on, Chairman Gray walked us through the budget process and presented us with a variety of options. The exercise was as sobering an experience as I have had since coming to Congress.

If there were to be no tax increases and we were to meet strict Gramm-Rudman targets, there would need to be draconian reductions in defense and domestic spending not to mention freezes of unprecedented size and scope. It became apparent that none were politically do-able. Revenue raising would have to be part of the package.

As a result of Chairman Gray's efforts, I have spent a considerable amount of time thinking about what our revenue raising options might be. I have come to the conclusion that this Committee should give consideration to imposing a temporary income tax surcharge on individuals and corporations in order to meet our revenue goals. My reasons are as follows:

(1) A tax surcharge is not a new idea. In 1968, a tax surcharge on individuals and corporations was enacted which was in effect for three years. It was levied at a 10 percent rate in 1968, 10 percent in 1969 and 5 percent in 1970. This raised $9.1 billion from individuals and $5.3 billion from corporations during fiscal year 1969 and fiscal year 1970.

In his fiscal year 1984 budget, President Reagan proposed a standby surtax of 5 percent on individuals and corporations. I recall that our former colleague, David Stockman, had something to do with persuading the President to accept it, but there it was in his budget proposal.

(2) A relatively small surtax can raise significant amounts of revenue. According to figures I have obtained from the Joint Committee on Taxation, each 1 percent surtax on individuals and corporations today would raise approximately $4 billion. Over 3 years it could raise $69.9 billion from individuals and corporations.

I am including with my testimony information developed by the Joint Committee on Taxation which shows the distributional tax effects of a 5 percent surtax on various income classes.

(3) Unlike some of the revenue proposals which would require complex regulations, a surtax would be easy to administer. It would require only one additional computation after arriving at the tax owed. What this means is that you get to the bottom line and then add an additional 5 percent.

(4) A surtax would not put back on the tax rolls the 6 million low-income individuals who were removed in the Tax Reform Act of 1986. This is because this would be a surtax on liability and if you don't have any tax liability then you won't have to pay a surtax.

(5) I might add that because of the base-broadening and loophole closings in the 1986 Tax Act, imposing a surtax would be more fair than ever before. There are now fewer tax games to be played so that the relative position of taxpayers is not changed through implementation of a tax surcharge.

(6) There would be no regional disruptions nor would specific industries be singled out as could occur with oil import fees which would hit hardest the Northeast and Midwest regions of the country. Likewise, excise tax increases would harm tobacco-growing regions of the country and parts of the Southwest and West where residents must drive their cars because of the lack of mass transit or because of long distances regularly traveled.

(7) A surtax is not inflationary. Excise taxes, on the other hand, can affect prices and show up in the Consumer Price Index as the taxes are passed on to consumers.

(8) Finally, history has shown that surtaxes, such as the one we had in 1968, are likely to be temporary. I think that all of us are concerned about putting into place a revenue-raising device that simply grows and grows and becomes a permanent part of the tax structure.

With a temporary surtax dedicated to deficit reduction—as the budget resolution would require—we can say to the American people that we are taking the responsible course, that we are willing to make the tough decision to raise revenues—even if our President isn't—and that we have a reasonable and understandable plan for accomplishing our goal. No smoke and mirrors. No accounting tricks. Instead, we offer a plan that is fair and understandable.

I urge your consideration of and support for a temporary surtax.

PERCENTAGE CHANGE IN INCOME TAX LIABILITY UNDER A 5 PERCENT SURTAX

Income class [1987 dollars]	Percentage change in income tax liability	Amount
0 to $10,000	([1])	[2] $20
$10,000 to $20,000	6.2	53
$20,000 to $30,000	5.2	102
$30,000 to $40,000	5.1	151
$40,000 to $50,000	5.1	223
$50,000 to $75,000	5.0	394
$75,000 to $100,000	5.0	682
$100,000 to $200,000	4.9	1,302
$200,000+	4.5	5,996
Total	5.0	([3])

[1] Percentage change not meaningful because tax liability negative under present law.
[2] Possible reduction in Earned Income Tax Credit for some taxpayers.
[3] Average for all taxpayers: $226.

Joint Committee on Taxation—July 1, 1987.
NB: The second column of figures represents an average for both individuals and married couples.

Mr. GUARINI. At the same time perhaps we will start off with our first witness, James Martin, a former member of our committee, a long respected member, and one who left us to become the Governor of North Carolina and who is serving with distinction there.

And, Jim, it's very good to see you back in the Ways and Means Committee room here. I want you to know we missed you.

STATEMENT OF HON. JAMES G. MARTIN, GOVERNOR, STATE OF NORTH CAROLINA

Governor MARTIN. Well, thank you very much, Chairman Guarini.

It is great to be back in these old haunts and to be here with my old committee.

On behalf of North Carolina's tobacco industry and farmers, I'm very pleased to be accompanied by Congressman Walter Jones, who is senior——

Mr. GUARINI. Yes, I'd like to also say that Walter Jones, we welcome you very much, Mr. Chairman. We're very pleased to have you here.

Will you both be testifying together?

Governor MARTIN. Well, he's here in support of my testimony and he hasn't even heard what it is yet.

Mr. GUARINI. OK. That's what you call faith.

Governor MARTIN. We also earlier had Congressmen Valentine, Price and Lancaster, who were here, and also Congressman Tallon of South Carolina who I believe will be speaking a little bit later.

Mr. GUARINI. They are all very welcome, and would you proceed, Jim?

Governor MARTIN. Thank you.

In a way this is a repeat of news that I've expressed to you before, even as a member of Ways and Means. I should say that I appreciate the opportunity to come and, once again, oppose the excise tax increase on cigarettes.

Of course, if it weren't for the honor of the thing, I would just as soon there not be any tax proposal to have to oppose. We see it as discriminatory against one class of consumers, discriminatory against the jobs of a category of workers, discriminatory against farmers of one commodity, and discriminatory against the economies of one small group of States that produce tobacco.

The doubling of the cigarette excise tax in 1983 has had an adverse effect on the economy of our State. Its effects have been well documented as to the loss in sales, jobs, and income of our historically No. 1 commodity, tobacco. The proposed doubling again in 1987 of the excise tax from 16 cents to 32 cents would have a severe devastating effect on our economy. It is anticipated, based on the past experience, that North Carolina would lose 3,600 jobs, and over $95 million in income and benefits in the tobacco industry. In addition, North Carolina would lose some $7 million in State and local tax revenues. North Carolina cannot afford to lose these jobs as a source of income during these days of severe economic stress in agriculture which, of course, afflicts our State and many other States.

Last year, North Carolina produced over two-thirds of the Flue-cured tobacco grown in the United States. Over 430 million pounds. Thousands of North Carolinians depend on tobacco directly or indirectly for their livelihood.

Our State grows Flue-cured tobacco leaf in the Piedmont and Coastal regions, and also grows burley tobacco in the western mountain counties. The golden leaf is grown on approximately 21,000 farms in North Carolina, and in 91 of our 100 counties. Cash receipts from tobacco amounted to over $681 million last year. Slightly over 20 percent of the cash receipts from all crops and all farm commodities came from tobacco, that is, in North Carolina.

The other end of the spectrum, cigarette manufacturers in North Carolina produced over 18.872 billion packs of cigarettes in 1986, and that's about 57 percent of all the cigarettes manufactured in the United Stases. North Carolina then is the largest tobacco manufacturing State in the Nation.

Other sectors of the North Carolina economy also benefit from the strength of our State's tobacco industry. There are tobacco auction markets in more than 30 counties. Tobacco offers a variety of other support industries: the largest cigarette paper factory in the Nation; chemical and plastic suppliers; packaging and container suppliers; cigarette filter producers; fertilizer and farm equipment suppliers; transportation industries, and on and on, commercial printing, and so forth, advertising.

All these industries produce important revenues and jobs for North Carolina as well as for other States. As you can well understand, every business must earn a profit if it is to grow or even survive. If North Carolina's tobacco agriculture is to be successful, it not only benefits the farmer, but it benefits everyone in our State.

Tobacco already carries its part of the tax load. It provides more and better jobs. And if North Carolina's agriculture is to be unsuccessful, then it will provide fewer and fewer jobs and less opportunities, and a weaker economy in our State.

The tobacco farmer has not shared in the economic recovery that most of the Nation has experienced in the last few years. Not only has he faced increased foreign competition, but also a decline in domestic consumption due, in part, to the doubling of the excise tax in 1982. The entire tobacco program was in jeopardy of collapse prior to the approval by Congress in 1985 of the Tobacco Reform Act.

These changes, as explained to you already by Mr. Fred Bond, who is the managing director of the Flue-Cured Cooperative Stabilization Corp., earlier in these hearings. These changes did bring some degree of stability to the program and allowed many of our tobacco farmers to realize a profit for the first time in several years, and gives them some encouragement for the future. But if you were to double the excise tax again, the resulting reduction in the sales could very well cause many of our tobacco farmers to be forced out of business.

A staff working paper published by the Congressional Budget Office in January of this year, stated, and I quote, "an increase in the excise tax on tobacco would be the most regressive of all the tax measures considered."

Taken as a percent of income, the tobacco excise tax is 27 times higher for low income, that is under $10,000 income families, than for high income families, those over $200,000. That's 27 times higher as a proportion of their income.

The tobacco grower would be unfairly disadvantaged by congressional action to raise this discriminatory tax on the product on which the grower depends for his livelihood.

In 1984, the Tobacco Institute reported that cigarette taxes collected at Federal, State, and local levels of government amounted to just over $9 billion, while U.S. tobacco farmers, who produced the domestic leaf for these cigarettes, received only $1.45 billion. In other words, cigarette excise taxes are already taking more than six times the farm value of domestic tobacco used in cigarettes. This makes cigarettes the most heavily taxed consumer commodity in the United States and, ironically, an increase in this Federal excise tax would erode the tax base and reduce the revenue of many of our sister States which already have a high tax on cigarettes and regard excise taxes as State revenue sources.

It is for this reason that the National Governors' Association is strongly opposed to any Federal excise tax increases.

So, in conclusion, Mr. Chairman, I hope that the tobacco grower will not be forgotten by my former colleagues when they deal with the future of the cigarette excise tax. To increase the excise tax above the current level would be unfair, unreasonable and unjustified. And I hope the committee will agree.

[The statement of Governor Martin follows:]

Statement of Honorable James G. Martin
Governor
State of North Carolina

The doubling of the cigarette excise tax in 1983 has had an adverse effect on the economy of North Carolina. Its effects have been well documented as to the loss in sales, jobs, and income of our historically number one commodity--tobacco. The proposed doubling, again, in 1987 of the excise tax from 16 cents to 32 cents would have a devastating economic effect. It is anticipated, based on previous experience, that North Carolina would lose 3,614 jobs and over $95.6 million in income and benefits in the tobacco industry. In addition, North Carolina would lose some $7.1 million in state and local tax revenues. North Carolina cannot afford to lose these jobs as the source of income during these days of severe economic stress in agriculture.

North Carolina last year produced over two-thirds of the flue-cured tobacco grown in the United States--over 430 million pounds. Thousands of North Carolinians depend on tobacco directly or indirectly for their livelihood.

The state grows flue-cured tobacco leaf in the Piedmont and coastal regions and also grows burley tobacco in the western mountain counties. The golden leaf is grown on approximately 21,000 farms in North Carolina and in 91 of North Carolina's 100 counties. Cash receipts from tobacco amounted to over $681 million in 1986. Slightly over twenty percent of cash receipts from all crops and all farm commodities came from tobacco.

At the other end of the spectrum, cigarette manufacturers in North Carolina produced over 18.872 billion packs of cigarettes in 1986. That's about 57.4 percent of all the cigarettes manufactured in the United States. North Carolina is the largest tobacco manufacturing state in the nation.

Other sectors of the North Carolina economy also benefit from the strength of the state's tobacco industry. There are tobacco auction markets in more than 30 counties in the state. Tobacco offers a variety of other support industries: The largest cigarette paper factory in the nation; chemical and plastic suppliers; packaging and container suppliers; cigarette filter producers; fertilizer and farm equipment suppliers; transportation industries; commercial printing; and advertising in the media.

All these industries produce important revenues for North Carolina and other states. Every business must earn a profit if it is to grow or even survive. If North Carolina's tobacco agriculture is successful, it not only benefits the farmer, but everyone. It carries its part of the tax load, it provides more and better jobs. If North Carolina's tobacco agriculture is unsuccessful, it provides fewer and fewer jobs and less opportunities for all.

The tobacco farmer has not shared in the economic recovery that most of the nation has experienced in the past few years. Not only has he faced increased foreign competition, but also a decline in domestic comsumption due, in part, to the doubling of the excise tax in 1982. The entire tobacco program was in jeopardy of collapse prior to the approval, by Congress, of the Tobacco Reform Act of 1985. These changes, as explained to you by Mr. Fred Bond, managing director of the Flue-Cured Cooperative Stabilization Corporation earlier in these hearings, brought some degree of stability to the program and allowed many of our tobacco farmers to realize a profit for the first time in several years. Doubling the excise tax, with the resulting reduction in consumption, could very well cause many of our tobacco farmers to go out of business.

A staff working paper published by the Congressional Budget Office in January 1987, stated that "an increase in the excise tax on tobacco would be the most regressive of all the tax measures considered." As a percent of income, the tobacco excise tax is 27 times higher for low-income (under $10,000) families than for high-income (over $200,000) families.

The tobacco grower would be unfairly disadvantaged by congressional action to raise the discriminatory tax on the product on which the grower depends for his livelihood.

In 1984, the Tobacco Institute reported that cigarette taxes collected at federal, state, and local levels of government amounted to $9.3 billion, while U.S. tobacco farmers who produced the domestic leaf for these cigarettes received only $1.45 billion. In other words, cigarette excise taxes are already more than six times the farm value of domestic tobacco used in cigarettes. This makes cigarettes the most heavily taxed consumer commodity in the United States today.

I hope that the tobacco grower will not be forgotten by my former colleagues when they deal with the future of the cigarette excise tax. To increase the cigarette excise tax above the current 16 cents per pack would be unfair, unreasonable, and unjustified.

Mr. GUARINI. Thank you, Governor.

There are many who think that the 6 million people that we tried to take off the tax rolls in tax reform would be the very ones that would be hit with this kind of a tax. As you pointed out, it is a regressive tax, and that it would be fairer to have a progressive type of tax if revenue does in fact have to be raised.

Was there any other tax that was in the option of taxes as the estate taxes or luxury taxes or rate freezes or advertising taxes that you had any opinion on that you would like to voice at this time?

Is there any other way you would advise Congress to go if they stay away from excise taxes?

Governor MARTIN. Mr. Chairman, you'll remember very well from my tour of duty on the committee and in conversations that we had after hours, that I would not likely be here to advocate any increase in taxes and, indeed, I am not here to advocate any increase.

I'm particularly speaking for a commodity of great importance to my State. You can well understand that, and will direct my comments to that. I'm not here to advocate tax increases.

Mr. GUARINI. The States have voiced opinions on many occasions of gasoline taxes and cigarette taxes being taxes that they themselves are beginning to rely more and more on, and that they need this as their preserve in order to have the tax base they need to finance the programs of their State.

Governor MARTIN. That's quite correct.

Mr. GUARINI. Do the Governors have that as a consensus, that an excise tax of this nature should be left to the States as a revenue base?

Governor MARTIN. Yes, Mr. Chairman. In the past, the National Governors' Association, of which I am now a member, has expressed its concern about the erosion of tax bases that are used actively by States. States do resort to excise taxes as a major source of income. And it's expected that the meeting week after next of the National Governors' Association that a specific resolution on this point will again be enacted.

But it has historically been the view of the State governments to resist and oppose any erosion of those historic areas of tax base, those historic sources that States have utilized.

Mr. GUARINI. Being on the Budget Committee, Jim, I can see how more and more we are putting onto the States various programs that heretofore have been part of the Federal Government's responsibility in this neofederalism to put more education, more environmental programs, more housing programs, et cetera, back on the States' backs.

So I guess that you need a more secure base to operate out of than what you presently have.

Governor MARTIN. You make a very good point, Mr. Chairman. Let me say to you that that policy and that pattern of transferring more and more of those kinds of responsibilities to the States is one which I personally welcome. I shared that view when I was a member of the Budget Committee, and I hold that view very firmly as a Governor.

There's some responsibilities that we know must be met on a national level. There are some that we would not be in a position to deal with. And yet there are others that we are very well able to deal with in managing our highway construction and building our schools and staffing them. And one thing that I'm very pleased to see is that in the part of the country where we are, the Southeastern United States, where for years schools were somewhat neglected, we're seeing a renaissance, a strong resurgence of support for building schools in our part of the country to be as good as those anywhere. And we're very proud of that commitment, and yet you're quite right, we need to have revenue sources to be able to meet that responsibility.

Mr. **GUARINI**. All right. Thank you very much.

My good colleague, Mr. Duncan.

Mr. **DUNCAN**. Thank you, Mr. Chairman.

Of course it's a pleasure to welcome the Governor back to the committee. As the chairman said, we do miss you and your expertise in so many, many different subjects.

I'm glad that you brought out the Congressional Budget Office study on the regressiveness of an additional tobacco tax, because many of our colleagues refuse to read that report, and the media often fail to mention the regressiveness.

You indicated that the tobacco tax was more of a tax against the poor. That is, the poor man, if you double the tax, he probably can't get his tobacco, but the wealthy man, regardless of what the tax might be, even $2 or $5 a pack, is going to smoke.

Would you say that about sums up the effect of the tax?

Governor **MARTIN**. Well, that's one of the consequences of it.

As you know, in previous discussions, your colleague, my former colleague, Mr. Rangel of New York, has made that very point very effectively. I think it does have to be pointed out.

What the Congressional Budget Office study showed was that if you assumed that it did not affect buying patterns, but that people continue to purchase at the same level, regardless of level of income, then it would have a much greater impact as a proportion of income for low income people than for high income people.

The conclusion was that for those with income of about $10,000 a year, it would have an effect of 27 times the proportionate effect on those with income of $200,000 a year.

Now, you could have other comparisons in between, but it's a very useful comparison because it shows that for the same degree of use, the tax would be proportionately much heavier on low income people.

Mr. **DUNCAN**. By and large, are your tobacco farmers low-income people?

Governor **MARTIN**. Well, some are and some are not. As you can imagine, with any profession, you're going to have some variety of economic situations. It depends a lot on what else they do and what other sources of income they might have.

But, characteristically, in North Carolina, our farms are not large corporate farming operations. The average farm size in North Carolina, Representative Jones, I believe is about 145 acres, is the average size. Well, that means we have some larger, not many that are much larger than that, a couple. We have some larger, but it means that we've got a lot that are smaller than that.

And if someone is trying to operate a farm on the order of 100 to 150 acres, that family needs that tobacco allotment to be able to maintain a decent standard of living.

And so for those smaller farmers, which is typical of our State, it's a critical part of their income.

And we saw that, in 1983, after the tax changes in 1982 were put into effect, we saw an impact, not only in the retail market but also in the quota that was allocated to the farmers and, therefore, to the farmers who could continue to stay in business.

Mr. DUNCAN. In eastern Tennessee, most of our farmers are very small. They have maybe an acre or less of tobacco allotment. For them, tobacco produces supplemental income to send their children to college, pay the tuition, or buy Christmas presents. The tobacco income isn't a big sum of money, but it's very important to those farmers. They are very low income people.

Governor MARTIN. Well, that's very similar in our State. You'd have to acknowledge that there will be some exceptions to that. But, as a general rule, that describes the situation in North Carolina also.

Mr. DUNCAN. May I say that I neither consume nor produce tobacco, nor do I have a financial interest in tobacco. When we doubled the tax from 8 to 16 cents, did you gather by implication or otherwise that that might be the last increase in tobacco tax for awhile?

Governor MARTIN. Well, that might have been said. But, you know, you never relax your alertness on that kind of subject. I think there'll always be people who will be proposing additional increases, and we just have to respond every time.

Mr. DUNCAN. OK. Thank you very much for being here, Governor, and thank you, Mr. Chairman.

Mr. GUARINI. Mr. Frenzel.

Mr. FRENZEL. Thank you, Mr. Chairman.

I want to welcome the Governor to the committee as everyone does. I certainly miss you. I've been forced to sit next to Congressman Schulze since you left. [Laughter.]

That's been quite a cross to bear. We also miss your dissertations in chemistry and physics when you explained to us about the need to take care of the——

Governor MARTIN. Whatever it is, I'm taking care of.

Mr. FRENZEL [continuing]. The synthetics. I never did understand those lectures, but I enjoyed them.

Governor MARTIN. That's why I gave you a low grade on the exams. [Laughter.]

Mr. FRENZEL. To tell you the truth, the person we really miss around here is the talented and beautiful Dottie Martin, and we don't even care if you ever come back.

Governor MARTIN. I'll sure tell her you said that. Thank you.

Mr. FRENZEL. I want to thank the gentleman for his testimony. I think he knows that a number of members of this committee are not sympathetic to this kind of tax or others. Governor, we appreciate your coming back and being willing to testify.

We don't have nearly enough chief executives of the States of the Union coming to us in person. When one comes, we really appreciate it.

Governor MARTIN. Well, thank you. I needed an excuse to get back here and haunt you guys again.

Mr. GUARINI. Mr. Dorgan.

Mr. DORGAN. Thank you, Mr. Chairman. And, Governor, welcome back.

Governor MARTIN. Thank you very much.

Mr. DORGAN. In North Dakota we don't have tobacco fields. I don't smoke. The result of that is that I don't frankly care what the price of cigarettes is. I don't lay awake worrying about that.

But, to the extent that we affect the price of tobacco products or cigarettes by government action, to the extent that we affix a tax which therefore affects price, I think all of us recognize that some person out there is going to pay that tax. The cigarette doesn't pay the tax; the person pays the tax. As we attempt to decide where to raise additional revenue, it's important for us to understand who ultimately will pay the tax and what the effect will be of that payment on various income classes of people.

So I think you've provided us some important information with respect to the regressivity. I don't think any of us want to be unmindful to all of the pros and cons of that tax, the excise tax generally, the income taxes and all the other things we're going to consider.

I did just want to say that you've provided us with some good and useful information.

Now, let me be a bit more general just for a moment. As Governor, you are required to take a look at your State's fiscal policy and reconcile expenditures and income. I heard your statement a few minutes ago that you weren't necessarily coming to the committee to suggest we increase taxes, you were here to talk about excise taxes and tobacco taxes.

But the committee is in a dilemma. We are, of course, required by the budget to come up with a tax bill. Some might think that's not the right approach, but others think that if you look objectively at the two remedies for Federal deficits, which I'm sure, as Governor, you would see as alarming, they are spending restraint and revenue. Some might say you can get all of the solution from spending restraint but frankly, Governor, you can't, you just can't.

All of us wish we could, but we can't. We do have to come up with additional revenue sources and are required to do that by the budget.

My general question to you is, as Governor, if you are involved in a forced choice of achieving some new revenue, what suggestions or recommendations would you have for us?

Governor MARTIN. Well, I have to say to you I'm going to decline to solve that particular problem for you, I would say with all due respect to my former colleague. I have to wrestle with those kind of things insofar as our State revenue sources are concerned, and did here when I was a member of this committee. And there were sometimes that I supported tax increases; there were sometimes that I supported tax cuts, depending on what the circumstances were.

I would comment and say if you could find a way to tie spending reductions to tax increases, you might get a lot further and a lot more support from both your colleagues in the Congress and the people around the country.

But, in fact, the way it works here is that the budget resolution, which states what the objective is going to be, never really achieves that purpose. The two different proposals come up at different times. They come from different committees. The revenue proposals come from this committee; the spending proposals come from the Appropriations Committee. This is, of course, a civics lesson that you understand very well.

But the result, for all practical purposes, is they never reach the floor in a package where a deal can be struck, where you can say we will do this on the spending side provided the revenues are changed.

Instead, it comes up as a separate issue on what the revenue changes are going to be. And the people who would resist that never have any security or satisfaction or confidence, or any kind of reassurance that anything is going to be done on the other side of the ledger. And that's the trap that you have.

In our State government, we are required by our constitution to balance the budget, and in your State and in most, almost all States we're required by our constitutions, and we do it for that reason. We have to have a mechanism that brings those balancing choices together at the same time.

You don't have that constitutional discipline here and, therefore, there is no mechanism that works.

Mr. DORGAN. I confess to you that I came to this town 7 years ago not supporting a constitutional amendment. But having received seven budgets from this President, I have changed my mind and believe that one may——

Governor MARTIN. Well, I wish he'd vetoed more of the spending bills, you know. From my point of view, I think you can understand that.

Mr. DORGAN. I understand that. I think both of us would agree that——

Governor MARTIN. And yet the time has come when we've got to impose that kind of discipline. It does work. It does work in the States that have that experience.

Mr. DORGAN. I think both parties and the executive branch and the legislative branch bear responsibility for the problem. The question is how do we solve it in the context of that solution? How do we raise taxes? You've given us some information about one area—excise taxes. You've given us your thoughts about how that might have impact on people in your part of the country and people in my part of the country. That's good information.

We can't make these decisions in a vacuum. You have provided us with some awfully good information, Governor. Thank you.

Governor MARTIN. Well, you raise the question who pays the taxes, said the consumer, but if the consumer doesn't pay it, the farmer will pay it. You see? Because if the consumer doesn't pay it, sales will be reduced, the farmer will have less to produce, and the farmer will end up paying that.

Mr. Dorgan. I think perhaps you and I have even debated the corporate income tax, on who pays that. But, on excise taxes, there's no debate. The excise taxes are paid by the person consuming the article on which the excise tax is applied.

Governor Martin. And it's very regressive.

Mr. Dorgan. Thank you.

Mr. Guarini. Mr. Schulze.

Mr. Schulze. Thank you, Mr. Chairman.

I, too, would like to welcome our colleague. It has been a pleasure to have you appear before us. I, too, miss you for the same reasons that Mr. Frenzel expressed. We wish you well.

We appreciate your testimony. I have one question, and that is, Jim, are you receiving some so-called bonus revenue, such as the revenue we've seen in capital gains, or any of the other actions that we've taken?

Governor Martin. Me personally? No.

Mr. Schulze. No. The State.

Governor Martin. No. In fact——

Mr. Schulze. Has the State gotten an increase in revenue because of the actions of the Congress.

Governor Martin. Oh, I see. Our State has made an estimate that we will gain a very small increase primarily from the termination of the favorable treatment for individual retirement accounts, and a little increase because of the capital gains.

We didn't have a capital gains provision in our State law. But there is going to be some change in business activity. It's difficult to estimate, but we do estimate about a $25 million pickup which, in terms of a $10 billion budget, is very small.

Mr. Schulze. I thank you for——

Governor Martin. We won't spend it all in one place.

Mr. Schulze. OK. I thank you, and I wish you well. Thank you, Jim.

Mr. Guarini. The bottom line is that North Carolina is a good place to move to?

Governor Martin. Good place to move, good place to invest, good place to visit, good place to hold hearings. Whatever you all want to do, Mr. Chairman.

Mr. Guarini. I wanted to give you that commercial.

Governor Martin. Yes, sir. Delighted. No. 1.

Mr. Guarini. Jim Moody.

Governor Martin. I just happen to carry this little card around with me. It's only a 2-inch column, but it's small enough to fit in my pocket. Ranked No. 1 for a place to invest.

Mr. Guarini. Right.

Mr. Moody. Governor, I'm happy to meet you and I'm sorry I didn't serve with you. But welcome to the committee.

This is not a budget hearing, but let me just briefly ask you a little bit about your proposition on balanced budgets for the Federal Government.

We in Wisconsin have a balanced budget requirement for our State also, but our State doesn't have any obligation to manage the macroeconomy of the Nation. And the fiscal stabilizers that are inherent in the federal system would be lost to a great extent if you took away the legal ability to run a deficit or, in fact, run a surplus. We don't run many surpluses, but it oscillates around some central number. And if you took that away, of course, you'd have to raise taxes in a recession, and you'd have to raise them even harder in a depression.

Wouldn't you agree that the State is in a very different—it has no Federal Reserve, it has no monetary policy, it doesn't have independent fiscal policy, it has no requirement or obligation to balance the economy. And after all, we don't want just a balanced budget, we want a balanced economy. And the fiscal stabilizers in the Federal system would be lost largely through a constitutional change that you suggest.

Do you agree, or am I off base here?

Governor MARTIN. I think you make a good point. I would have to say as one partial disclaimer though, that we do feel a very strong sense of responsibility for helping to build the economy of our States. And to the extent we succeed in that, of course, that helps to build the economy of the United States of which we're all a part.

But let me say this. It's true that you have business cycles to take into account. But my feeling about that always was, at the time that I served on this committee and the Budget Committee, is that you should at least seek to balance the budget over a business cycle.

Yes, when you're in a recession, your expenses go up and your revenues go down. And it might be self-defeating to plunge in right at that time to raise taxes or cut programs.

Mr. MOODY. Right.

Governor MARTIN. But, in other years, we run deficits when we ought to be able to pay off some of the previous deficits.

So I would say you should consider an amendment, a constitutional amendment that would take into account that business cycle so that over the average you keep it in balance. But we don't even do that.

Mr. MOODY. No. And I would agree. That's a very important caveat that not very many people recognize. But that's my only question. Thank you very much.

Mr. GUARINI. Mr. Levin.

Mr. LEVIN. I am sorry I am late. I will catch up. Give me an hour, Governor, and I will catch up.

Mr. GUARINI. We thank you, Governor. We wish you well, and our thoughts are always with you.

Mr. MARTIN. Mr. Chairman, thank you very much for this opportunity.

Mr. GUARINI. Good luck to you and thank you for the benefit of your testimony.

Mr. MOODY. Mr. Chairman, the schedule shows me as—I do not know if your intentions are to break now to vote. Is there a vote on?

But I would recommend that the Glenn Anderson panel, including Congressman Hammerschmidt, go ahead of me. I am next to testify, but since I am on the committee, I can fill in later. Why do we not allow our visitors to plan to be next, if you want to go vote now.

Mr. GUARINI. Bud Shuster is not here yet, is he?

Mr. SHUSTER. Yes.

Mr. GUARINI. All right, fine.

Mr. MOODY. So why do we not go ahead and——

Mr. GUARINI. We will call the Committee on Public Works and Transportation, the Honorable Glenn M. Anderson, California, chairman of the Subcommittee on Surface Transportation, the Honorable John Paul Hammerschmidt, Arkansas, and the Honorable Bud Shuster, Pennsylvania.

Mr. GUARINI. The Chair feels that inasmuch as everyone that is involved, both at the counsel table as well as the committee bench here that we have to vote, perhaps we will take a 10-minute break and come right back. So we will start at 12:15. Thank you.

[Recess.]

Mr. GUARINI. I do believe we can begin, if you gentlemen are willing to begin. The Republicans will be coming in shortly, so let us start, if we can. Who will be the leadoff, Mr. Glenn Anderson, as the chairman of the Subcommittee on Surface Transportation?

Mr. ANDERSON. I suppose.

Mr. GUARINI. We welcome you and we appreciate your help.

STATEMENT OF HON. GLENN M. ANDERSON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA, AND CHAIRMAN, SUBCOMMITTEE ON SURFACE TRANSPORTATION, COMMITTEE ON PUBLIC WORKS AND TRANSPORTATION

Mr. ANDERSON. Thank you, Mr. Chairman. And I do appreciate having the opportunity to appear here today to let you know of my strong opposition to any increase in our nation's highway user fees for deficit reduction purposes.

I suppose I should preface these remarks by saying that we do need to reduce and eventually eliminate the Nation's deficit. In fact, I would hope that in time we will be in a position to reduce our backlogged national debt, which is such a great drain on the Nation's economy.

Let me say further that though Chairman Howard is unable to join us today—he is out of town—he has asked me to let you know of his support for what we are saying here. I am flanked on my right by Mr. Hammerschmidt, who is the ranking member of the full Public Works Committee, and on my left is Mr. Shuster, the ranking member of the Subcommittee on Surface Transportation. So you have the two top Democrats and the two top Republicans united in this position.

And I might also say that the four of us are going to be introducing a resolution today expressing the sense of the House of Representatives that the Federal excise taxes on gasoline and diesel fuel shall not be increased to reduce the Federal deficit. Again, this will be coauthored by myself, Mr. Hammerschmidt, Mr. Shuster, and Mr. Howard. And so again, we are showing our unity on this.

And just 2 weeks ago, the Surface Transportation Subcommittee held hearings on the very issue that we are addressing today: the advisability of increasing motor fuel taxes for deficit reduction purposes. And what I would like to do today is to share with this committee my conclusions from that hearing.

The first message I would want to leave with you is that a motor fuel tax increase is a very regressive tax increase. And while such a tax might be justified if it is a user fee that is, if the revenues generated are utilized to provide services related to the payment—it is difficult to justify when used for general government purposes, such as deficit reduction.

You know, in the past year or two there has been a great deal of discussion about our progressive tax system. Those who advocated a leveling out of income tax categories were sometimes criticized for abandoning the principle of progressive taxation. And they were very sensitive to any such criticism, saying that when coupled with the closing of loopholes, that the progressive nature of our system was preserved.

Now of course, there are some who argue for a flat tax. Well, motor fuel taxes are not progressive. They are not flat. They are very, very regressive. As one's income decreases, the percentage of one's income that is taxed by this mechanism actually rises; 23.2 percent of the general excise tax is generated from families earning under $20,000 a year, who account for just 10½ percent of our total economic income. Conversely, only 5 percent of this excise tax is levied against families earning over $100,000 a year; those which account for about 15 percent of all economic income. I would sincerely hope that each member on this committee take these facts to heart.

Now most excise taxes are regressive. I would suggest though that it is particularly egregious to impose such a tax on the products, the consumption of which are nonelective. There is, of course, ample precedent for such a principle. Many States impose a sales tax on food consumed in restaurants, a presumed nonnecessity, but exempt groceries from the tax. Regardless of the income, we have to eat. And I would suggest that in today's society, there is often little practical alternative to the automobile for many of our daily trips. Thirty-five percent of household travel is either to work or work-related. And an additional 34 percent is for family business, shopping, medical, school or church trips. So over two-thirds of all auto travel is nonelective.

A motor fuels tax increase would be unfair, not only to the low and moderate income families, but it is bad for all America. Compared to generating comparable amounts from an oil import fee, an income tax surcharge, a corporate tax increase, or a tobacco tax increase, a gasoline tax increase would have the greatest negative impact on unemployment and our gross national product. It would also have a greater inflationary impact on the economy than any of these except an oil import fee, the inflationary impact of which would be similar to that of a gasoline tax increase.

A 10 cent gasoline tax increase when used for deficit reduction purposes, would add 80,000 people to the unemployment rolls by next year, and 180,000 to the unemployment rolls by 1990. And the GNP, the gross national product, would decline by $10 billion. The Consumer Price Index would rise by 0.3 percent. I would suggest to the members of this committee that these numbers, the result of a Wharton Econometrics analysis are more than alarming.

Mr. Chairman, I have already suggested that it is unfair that the wealthiest among us, those who have enjoyed the fruits of our economic practices over the years should bear the smallest relative burden of sacrifice for healing our economy. This though is not the only inequity that is created by a gasoline or diesel tax increase.

It is inequitable that one class of Americans, the highway user, should shoulder any special responsibility for reducing the deficit. And I would invite any of my colleagues to try to explain to me why an individual's contribution to deficit reduction should be based upon his or her number of miles driven. The nexus simply escapes me.

Mr. Chairman, I have to argue this point against motor fuels tax increase for reasons of equity and economy. While I share this committee's deep and abiding interest in questions of equity and economy, I would not suggest that I share your expertise. Over the years you have sat through many hearings addressing many such issues.

I would suggest, though, that over the years I have sat through many hearings on issues related to our Nation's transportation programs. And so I would like to turn now to the devastating impact that a motor fuels tax increase would have on transportation in this country. I have used the word devastating, and that is a word I have chosen carefully.

The transportation needs around our country are great.

Our Nation's annual Federal aid highway needs have been documented by the experts as being in the $20 to $25 billion range. The Federal Government should invest $20 to $25 billion a year simply to maintain current highway service levels. The new highway transit law funds our highway program at less than $14 billion. So we are running with a $10 billion a year negative impact on our highway system.

Our annual public transit capital needs total up to about $6 billion a year. And our new surface transportation law will provide about $2.6 billion; again a severe shortfall.

Mr. Chairman, I hope these few numbers help your committee understand the degree of hand-wringing that we experience on our committee. We are failing to meet our country's transportation needs, and we know it and it is most frustrating. It is particularly frustrating, I might submit, when we note that our Nation's highway users have already contributed $10 billion in user fees that we have been prevented from using. And of course, this $10 billion balance in the trust fund does on paper, make our Nation's deficit appear a bit smaller than it actually is.

Now at a time when the Federal Government is unable to meet our Federal transportation needs, we are chagrined that we must depend upon States and cities to bail us out. But that is the case. And I am happy to report that many States have tried to respond. In 1986, 27 States considered legislation to increase their motor fuel tax revenues, following a trend we have seen over the past few years. This trend though is likely to come to a halt if the Federal Government imposes a motor fuels tax increase of our own. Such an increase would certainly inhibit the ability of States to raise their own fees.

Now, Mr. Chairman, it is bad enough that we do not meet our transportation needs. It is worse if we preclude the States from filling the void created by our funding shortfall. But let me remind the committee of one additional effect of a Federal motor fuel tax increase. Because of the elasticity of demand on motor fuels, a Federal tax increase would reduce the amount of revenues generated by State taxes even at their current rates. By the fifth year of a 10-cent per gallon Federal tax increase, States would be losing almost $1 billion a year. Now, Mr. Chairman, we should not ask the States to help meet the Federal needs on the one hand, while we are picking their pocket with the other.

To sum, we need to reduce the Nation's deficit. We need to do this though by methods other than a motor fuels tax increase. Such a tax would be unfair, severely damaging to the Nation's economy, and destructive to our Nation and to our transportation network. Of these facts, I am convinced.

I was just handed a list a moment ago of some of the organizations which have endorsed this position in opposition. Those who oppose the gas tax increase for this purpose include the National League of Cities, the National Governors' Association, the National Conference of State Legislatures, National Association of Counties, the American Public Transit Association, the American Association of State Highway and Transportation Officials, Highway Users Federation, American Trucking Associations, American Automobile Association, Association of General Contractors, American Road and Transportation Builders Association, the secretary of the Florida Department of Transportation, the Center for Auto Safety, the California Highway Users Conference, and I could go on and on.

Thank you, Mr. Chairman. I have two gentlemen on both sides of me who can tell it a lot better than I can, so I will stop right there.

Mr. GUARINI. All right, thank you very much, Glenn. John Paul, do you wish to augment the statement?

STATEMENT OF HON. JOHN PAUL HAMMERSCHMIDT, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF ARKANSAS, AND RANKING MINORITY MEMBER, COMMITTEE ON PUBLIC WORKS AND TRANSPORTATION

Mr. HAMMERSCHMIDT. Thank you very much, Mr. Chairman, and Mr. Duncan, and members of the committee. We very much appreciate Mr. Moody yielding his time to us.

I have looked at your witness list. I know you have a lot of Members testifying today. Because of that, and because the distinguished chairman of our subcommittee has made every major point that I intended to make in my formal statement, I will not say much. I do want to reiterate one point, and then I would ask just to submit my statement for the record.

Mr. Chairman, as we all know, for the past 30 years our very successful Federal aid highway program has been supported from the excise tax on gasoline and diesel fuel collected from users of the system. And since 1982, our important public transit programs have also benefited from a portion of that tax.

Now this program has worked because it has acceptance. And it has been accepted by users of the system because it has been equitable and fair. All have shared in the benefits that have accrued to the Nation's roads from this user fee program.

The very principles of equity and fairness that have been the strength of the program would be dangerously undermined were we to turn gasoline and diesel fuel taxes from the support for the system to the broader purpose of deficit reduction. The entire funding mechanism and the stability of the highway program, so important to our nation's economic vitality, would be seriously jeopardized.

That is the only point I wanted to reiterate from Mr. Anderson's very fine statement. And I would ask to submit my longer statement for the record, Mr. Chairman.

[The statement of Mr. Hammerschmidt follows:]

STATEMENT BY JOHN PAUL HAMMERSCHMIDT
ON PROPOSED INCREASE IN
TAX ON GASOLINE FOR DEFICIT REDUCTION
WAYS AND MEANS COMMITTEE HEARING
JULY 15, 1987

MR. CHAIRMAN, I APPRECIATE THIS OPPORTUNITY TO PRESENT TO THE DISTINGUISHED MEMBERS OF THE COMMITTEE ON WAYS AND MEANS MY THOUGHTS ON PROPOSALS NOW UNDER CONSIDERATION THAT WOULD INCREASE THE TAX ON GASOLINE AND DIESEL FUEL FOR THE PURPOSE OF REDUCING THE FEDERAL DEFICIT.

CLEARLY DEFICIT REDUCTION SHOULD RECEIVE THE HIGHEST POSSIBLE PRIORITY, AND IT IS NOT ONLY APPROPRIATE BUT ESSENTIAL THAT THIS COMMITTEE AND THIS CONGRESS EXAMINE CAREFULLY AND SERIOUSLY ALL PROPOSALS THAT HAVE AS THEIR PURPOSE AN IMMEDIATE AND SUBSTANTIAL REDUCTION IN THE SOARING DEFICIT.

HOWEVER, PROPOSED LEGISLATION TO FURTHER INCREASE FEDERAL GASOLINE AND DIESEL FUEL TAXES FOR DEFICIT REDUCTION VERY CLEARLY DEMONSTRATES THAT HOW WE MAKE THE REDUCTION IS AT LEAST AS IMPORTANT AS THE REDUCTION ITSELF.

FOR THE PAST 30 YEARS, OUR VERY SUCCESSFUL FEDERAL-AID HIGHWAY PROGRAM HAS BEEN SUPPORTED FROM THE EXCISE TAX ON GASOLINE AND DIESEL FUEL COLLECTED FROM USERS OF THE SYSTEM. AND, SINCE 1982, OUR IMPORTANT PUBLIC TRANSIT PROGRAMS HAVE ALSO BENEFITED FROM A PORTION OF THAT TAX.

THIS PROGRAM HAS WORKED BECAUSE IT HAS ACCEPTANCE, AND IT HAS BEEN ACCEPTED BY USERS OF THE SYSTEM BECAUSE IT HAS BEEN EQUITABLE AND FAIR. ALL HAVE SHARED IN THE BENEFITS THAT HAVE ACCRUED TO THE NATION'S ROADS FROM THIS USER FEE PROGRAM.

THE VERY PRINCIPLES OF EQUITY AND FAIRNESS THAT HAVE BEEN THE STRENGTH OF THE PROGRAM WOULD BE DANGEROUSLY UNDERMINED WERE WE TO TURN GASOLINE AND DIESEL FUEL TAXES FROM SUPPORT FOR THE SYSTEM TO THE BROADER PURPOSE OF DEFICIT REDUCTION. THE ENTIRE FUNDING MECHANISM AND THE STABILITY OF THE HIGHWAY PROGRAM, SO IMPORTANT TO OUR NATION'S ECONOMIC VITALITY, WOULD BE SERIOUSLY JEOPARDIZED.

WE MUST REALIZE THAT FEDERAL FUNDING FOR OUR TRANSPORTATION PROGRAMS ARE NOT EVEN NOW SUFFICIENT TO MEET EXISTING NEEDS. STATE AND LOCAL GOVERNMENTS CAN HARDLY EXPECT TO MAKE UP THE DIFFERENCE IF THEIR EFFORTS TO RAISE REVENUES MUST COMPETE WITH A NEW FEDERAL GASOLINE TAX, NOT ONE PENNY OF WHICH WILL BE USED TO MEET TRANSPORTATION NEEDS. MOREOVER, WITH A REDUCTION IN GASOLINE CONSUMPTION CERTAIN TO RESULT FROM THE TAX INCREASE, STATE AND LOCAL GOVERNMENTS CAN EXPECT TO LOSE BILLIONS FROM WHAT THEY EXPECTED FROM THEIR EXISTING TRANSPORTATION REVENUE PROGRAMS.

CERTAINLY THE THREAT POSED BY THE EXCISE TAX INCREASE IN CURRENT PROPOSALS TO THE USER-SUPPORTED TRUST FUND CONCEPT AND TO OUR ABILITY TO USE IT IN FUTURE HIGHWAY PROGRAM REAUTHORIZATIONS IS VERY REAL. AND YET, THERE ARE OTHER UNWELCOMED CONSEQUENCES AS WELL.

THE JULY 1 HEARING CONDUCTED BY THE PUBLIC WORKS AND TRANSPORTATION COMMITTEE ON PROPOSED FEDERAL GASOLINE EXCISE TAX INCREASES PRODUCED SOME RATHER ALARMING PROJECTIONS AND STRONG OPPOSITION FROM ALL BUT ONE OF THE WITNESSES WHO APPEARED. THE SINGLE EXCEPTION WAS THE AUTHOR OF LEGISLATION CONTAINING A 9-CENT-PER-GALLON INCREASE IN GASOLINE AND GASOHOL EXCISE TAXES.

FOR EXAMPLE, AN ECONOMIC ANALYSIS OF GASOLINE TAX INCREASES MADE BY WHARTON ECONOMETRIC FORECASTING ASSOCIATES REVEALED THAT ADDING 10 CENTS MORE TO THE COST OF A GALLON OF GASOLINE WOULD REDUCE THE GROSS NATIONAL PRODUCT BY ALMOST $10 BILLION IN THE FIRST YEAR OF THE TAX ALONE.

AUTOMOBILE PRODUCTION WOULD DROP BY 1.3 PERCENT; HOUSING CONSTRUCTION WOULD FALL 0.9 PERCENT; AND 80,000 AMERICANS WOULD BE OUT OF WORK NEXT YEAR, WITH ANOTHER 180,000 UNEMPLOYED BY 1990. OF COURSE, A HIGHER TAX, AS HAS ALSO BEEN PROPOSED, WOULD ONLY ENLARGE ON THESE NEGATIVE IMPACTS.

ON ITS VERY FACE, AN EXCISE TAX ON GASOLINE IS EXTREMELY REGRESSIVE. THE POOR WOULD PAY A HIGHER PERCENTAGE OF THEIR AVAILABLE INCOME THAN THE WEALTHY. IT IS HARDLY REASONABLE OR APPROPRIATE THAT LOW AND MODERATE INCOME GROUPS SHOULD PAY A GREATER SHARE TO REDUCE THE FEDERAL DEFICIT THAN THOSE IN HIGHER INCOME BRACKETS. SIMPLY PUT, THERE IS NO "ABILITY TO PAY" CRITERION INVOLVED IN THESE PROPOSALS.

IN ADDITION, I AM GREATLY CONCERNED THAT THESE TAX PROPOSALS WOULD PRODUCE REGIONAL INEQUITIES. AS OUR COMMITTEE'S HEARING ON THIS MATTER BROUGHT OUT TIME AND AGAIN, THOSE WHO LIVE IN RURAL AMERICA WOULD CARRY THE HEAVIEST BURDEN BECAUSE THEY ARE MORE DEPENDENT ON AUTOMOBILE TRANSPORTATION AND THEIR PER CAPITA CONSUMPTION OF GASOLINE IS HIGHER THAN IN URBAN AREAS.

ACTUALLY, THE SIZE OF THE DEFICIT REDUCTIONS PROJECTED BY THE SPONSORS OF THESE PROPOSALS IS SUBJECT TO CERTAIN QUALIFICATIONS FROM THE VERY OUTSET. FOR EXAMPLE, GROSS REVENUES FROM A 10-CENT GASOLINE TAX MIGHT INDEED AMOUNT TO $8 OR 9 BILLION; BUT THAT AMOUNT WOULD BE REDUCED BY RESULTING SMALLER PERSONAL INCOME TAX RECEIPTS AND INCREASED EXPENDITURES FOR UNEMPLOYMENT PAYMENTS AND FOOD STAMPS, OR THE SO-CALLED "SAFETY NET" EXPENDITURES. AFTER ALLOWING FOR THESE REVENUE IMPACTS, WHARTON ECONOMETRIC FORECASTING ASSOCIATES HAS PROJECTED AN ACTUAL BUDGET DEFICIT REDUCTION OF $6 BILLION.

IN ANY EVENT, I WOULD ONCE AGAIN REMIND THE MEMBERS OF THE COMMITTEE OF THE SUCCESS WE HAVE ENJOYED UNDER THE USER-FINANCED HIGHWAY TRUST FUND. THIS IS BOTH A FAIR AND WORKABLE PROGRAM. ITS FUNDING MECHANISM DOES NOT DESERVE TO BE USED FOR DEFICIT REDUCTION. IN POINT OF FACT, IT ALREADY SUFFERS ENOUGH FROM THE FRAUDULENT BUDGETARY PRACTICE OF FREEZING TRUST FUND BALANCES FOR THE SOLE PURPOSE OF MAKING THE FEDERAL DEFICIT LOOK SMALLER ON PAPER THAN IT IS IN REALITY. HOW IRONIC THAT A PROGRAM THAT HAS NOT CONTRIBUTED A DIME TO THE FEDERAL DEFICIT SHOULD BE SO WRONGFULLY MANIPULATED.

YET, EVEN AS IT SUFFERS THIS NEEDLESS BURDEN, THE PROGRAM HAS BEEN HIGHLY EFFECTIVE. I, THEREFORE, CAUTION MY COLLEAGUES ON THIS COMMITTEE AND THROUGHOUT THE CONGRESS THAT WE PLACE OUR HIGHWAY AND PUBLIC TRANSIT PROGRAMS IN GREAT JEOPARDY IF WE PROPOSE TO GO DOWN THIS ROAD IN THE NAME OF DEFICIT REDUCTION. MOST ASSUREDLY, THIS IS THE TIME TO REDUCE THE FEDERAL DEFICIT, BUT THIS NOT THE WAY TO DO IT.

Mr. **Guarini**. Certainly, so ordered. Bud.

STATEMENT OF HON. BUD SHUSTER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF PENNSYLVANIA, AND RANKING MINORITY MEMBER, SUBCOMMITTEE ON SURFACE TRANSPORTATION, COMMITTEE ON PUBLIC WORKS AND TRANSPORTATION

Mr. **Shuster**. Thank you very much, Mr. Chairman. And Mr. Chairman, I am simply here to vigorously support the statements made by Glenn Anderson, John Paul Hammerschmidt, and Jim Howard, the chairman of our full committee. So recognizing the tight schedule you have today and the outstanding job that Glenn Anderson has already done, I would simply ask unanimous consent that my statement be included in the record in its entirety.

[The statement of Mr. Shuster follows:]

STATEMENT BY THE HONORABLE BUD SHUSTER
ON PROPOSALS TO INCREASE GASOLINE AND DIESEL EXCISE TAXES
FOR DEFICIT REDUCTION PURPOSES
BEFORE THE WAYS AND MEANS COMMITTEE
JULY 15, 1987

MR. CHAIRMAN, I APPRECIATE THE OPPORTUNITY TO PRESENT MY VIEWS BEFORE THE DISTINGUISHED MEMBERS OF THE COMMITTEE ON WAYS AND MEANS AS YOU CONSIDER OPTIONS TO RAISE $19 BILLION IN ADDITIONAL REVENUE CONTEMPLATED IN THE CONGRESSIONAL BUDGET RESOLUTION FOR FY 1989.

THE CONGRESS HAS SET DEFICIT REDUCTION AS A HIGH PRIORITY AND I JOIN MY COLLEAGUES IN A GENUINE DESIRE TO BRING SOARING DEFICITS UNDER CONTROL. I AM, HOWEVER, TROUBLED BY A NUMBER OF THE OPTIONS THAT HAVE BEEN PROPOSED TO REACH THE $19 BILLION REVENUE TARGET.

THIS MORNING, I WOULD LIKE TO SPECIFICALLY ADDRESS MY REMARKS TO THE VARIETY OF PROPOSALS THAT INCORPORATE AN INCREASE IN MOTOR FUELS EXCISE TAXES AS PART OF A DEFICIT REDUCTION PACKAGE.

ON THE SURFACE, THESE PROPOSALS MAY AT FIRST APPEAR ATTRACTIVE. GASOLINE AND DIESEL FUELS ARE SELLING FOR 20 TO 30 CENTS PER GALLON LESS THAN THEY WERE A YEAR AGO, AND THE PRICE THAT AMERICANS PAY FOR GASOLINE IS FAR LESS THAN IN EUROPE.

HOWEVER AS TESTIMONY PRESENTED AT A RECENT PUBLIC WORKS HEARING REVEALED, THERE ARE A NUMBER OF NEGATIVE EFFECTS ASSOCIATED WITH A GAS TAX INCREASE THAT BEAR EXAMINATION BEFORE SUCH PROPOSALS ARE ADOPTED. I WOULD LIKE TO EXPLORE SOME OF THE MORE SIGNIFICANT IMPACTS WITH YOU THIS MORNING.

FOR THE PAST 30 YEARS, THE MOTOR FUELS EXCISE TAXES HAVE BEEN THE CORNERSTONE OF THE USER-FEE FINANCED FEDERAL-AID HIGHWAY PROGRAM. THIS PROGRAM HAS BEEN A MODEL FEDERAL-STATE PARTNERSHIP THAT HAS PRODUCED THE NATION'S GREATEST PUBLIC WORKS PROJECT -- THE INTERSTATE HIGHWAY SYSTEM. THE PROGRAM HAS HAD BROAD PUBLIC SUPPORT AND ACCEPTANCE BECAUSE IT IS USER FEE FINANCED AND THE FINANCING MECHANISM IS FAIR AND EQUITABLE -- THE MORE YOU USE THE SYSTEM, THE MORE YOU PAY.

IN SPITE OF THIS SUCCESS STORY, THERE ARE TREMENDOUS UNMET TRANSPORTATION NEEDS ACROSS THIS COUNTRY. IT IS ESTIMATED THAT TO MAINTAIN OUR HIGHWAYS AT THE 1983 LEVELS, AN INVESTMENT OF $20 BILLION ANNUALLY IS NEEDED. FURTHER, $51.4 BILLION IS NEEDED TO BRING BRIDGES UP TO CURRENT STANDARDS AND $19.3 BILLION IS NEEDED TO COMPLETE THE INTERSTATE SYSTEM.

THE CURRENT PROPOSALS TO USE MOTOR FUELS TAXES FOR DEFICIT REDUCTION PURPOSES SIGNIFICANTLY JEOPARDIZES THIS SUCCESSFUL PROGRAM, BUT ALSO HAS A NUMBER OF ADVERSE ECONOMIC IMPACTS. IT IS ESTIMATED THAT A 10 CENT INCREASE IN THE GASOLINE EXCISE TAX WILL COST 80,000 JOBS WITHIN ONE YEAR AND 180,000 JOBS IN THREE YEARS; THE GROSS NATIONAL PRODUCT WOULD DECLINE BY $10 BILLION IN THE FIRST YEAR; THE CONSUMER PRICE INDEX WOULD RISE 0.3 % AND AUTOMOBILE PRODUCTION WOULD DECREASE BY 1.3 %.

IN CONTRAST TO THE EQUITABLE, "PAY AS YOU GO" NATURE OF THE GAS TAX WHEN IT IS A USER FEE, A GAS TAX IS EXTREMELY REGRESSIVE AND CAUSES REGIONAL INEQUITIES WHEN USED FOR DEFICIT REDUCTION PURPOSES. A CENTRAL THEME OF THE NATION'S TAX SYSTEM IS "ABILITY TO PAY". THE GAS TAX, IF USED FOR DEFICIT REDUCTION WOULD PLACE A LARGER BURDEN ON POOR TAXPAYERS. OF FURTHER CONCERN IS THE UNEQUAL BURDEN THAT RURAL TAXPAYERS WOULD SHOULDER IN CONTRAST TO URBAN TAXPAYERS, SINCE OUT OF NECESSITY, RURAL TAXPAYERS MUST DRIVE LONGER DISTANCES AND PAY MORE GAS TAX AS A RESULT.

IN A NUMBER OF THE PROPOSALS THAT ARE UNDER CONSIDERATION, THE GAS TAX HAS BEEN GROUPED WITH OTHER EXCISE TAXES ON LIQUOR, BEER, ETC., IN A DEFICIT REDUCTION PACKAGE. UNFORTUNATELY, THE IMPRESSION THAT IS DRAWN FROM SUCH A GROUPING IS THAT GASOLINE CONSUMPTION IS AS DISCRETIONARY AS SAY BEER OR LIQUOR CONSUMPTION. NOTHING COULD BE FARTHER FROM REALITY. NEARLY 70 PERCENT OF ALL DRIVING IS WORK RELATED OR FOR ESSENTIAL FAMILY BUSINESS.

OF PARTICULAR CONCERN TO OUR COMMITTEE IS THE IMPACT OF THESE PROPOSALS ON OUR FUTURE FEDERAL TRANSPORTATION PROGRAM AND THE IMPACT ON STATE TRANSPORTATION PROGRAMS. A NUMBER OF THE WITNESSES AT OUR PUBLIC WORKS HEARING REPRESENTING STATES AND LOCAL UNITS OF GOVERNMENT EMPHASIZED THEIR CONCERN THAT AN INCREASE IN THE FEDERAL MOTOR FUELS TAXES, THAT WAS NOT DEDICATED FOR TRANSPORTATION PURPOSES, WOULD SEVERELY HAMPER BOTH THE FEDERAL AND STATE FINANCED TRANSPORTATION PROGRAMS. TRADITIONALLY, STATES UTILIZE MOTOR FUELS TAXES TO FINANCE THEIR HIGHWAY PROGRAMS, WHICH INCLUDE NEW CONSTRUCTION, REHABILITATION, AND ROUTINE MAINTENANCE. IF THE FEDERAL GOVERNMENT SHOULD RAISE THESE TAXES FOR DEFICIT REDUCTION, THEY BELIEVED THEY WOULD BE PRE-EMPTED FROM FURTHER USE OF THIS SOURCE OF REVENUE IN THE FUTURE FOR TRANSPORTATION PURPOSES. THEY ALSO EXPRESSED CONCERN THAT A NATIONAL PRECEDENT WOULD BE ESTABLISHED THAT MIGHT ENCOURAGE STATE GOVERNMENTS TO DIVERT MOTOR FUELS TAXES TO GENERAL FUND PURPOSES, A PRACTICE THAT, UP TO NOW, HAS BEEN VERY LIMITED.

FOR ALL OF THESE REASONS, MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE, I BELIEVE YOU WOULD BE ILL ADVISED TO USE THIS TRADITIONAL USER-FEE AS A METHOD TO RAISE REVENUES FOR DEFICIT REDUCTION.

Mr. GUARINI. It will be so placed in the record. Let me ask you, gentlemen, you are equally against any import tax, I assume; is that correct, on gasoline?

Mr. SHUSTER. I am certainly opposed to an import fee on gasoline.

Mr. GUARINI. The same with the others?

[Nodding affirmatively.]

Mr. GUARINI. The trust fund went into effect in 1956 for the highway trust fund and apparently has worked very well. I understand that they have extended it now for a 5-year period. And during that 5-year period you expect to raise about $68 billion over that length of time. Is that a correct statement?

Mr. ANDERSON. Sounds about right, yes.

Mr. GUARINI. If it is extended for 5 years, there would not be any intrusion on your trust fund during that period of time. You are not contemplating asking any increase of taxes between now and the next 5 years, are you?

Mr. ANDERSON. No, except that we do know, as I mentioned earlier, we are running a negative balance each year where we are not spending enough or raising sufficient taxes to meet our actual needs. So every year we are going about $10 billion farther away from meeting our highways needs in this country. So if we keep things at our present level, we are still falling behind. And of course, anything else would just take it and make it that much worse.

Mr. SHUSTER. Mr. Chairman, if I might add to that. It is clear that the needs are not being met. It is also clear that as long as the highway trust fund is on budget, we are not even going to be able to expend the monies flowing into that trust fund for the purposes for which they are intended.

So one of the solutions, one of the first solutions before there is any increased taxes to pay for the needed, unmet needed highway projects would be to take the highway trust fund off budget so that the fund, rather than building up a surplus to mask the general fund deficit could be spent for the purpose for which it was intended, and that is for highways.

Beyond that, this member would support an increase in the gasoline tax if it were dedicated to improving the Nation's highways and transit systems. However, I hope I am realistic enough to realize that the climate is not here now for that kind of an increase. And I do not intend to walk the plank alone.

But if the political climate would coalesce, I would not be adverse to increasing the Federal gasoline tax, but only as a user tax for being expended on the Nation's highways and transit systems.

Mr. ANDERSON. I support the gentleman's statement 100 percent plus.

Mr. GUARINI. Now all of us are going to have to bite the bullet, face the fact that revenues may have to be raised. And although this may not be your form of expertise, you know what you are against. What would be acceptable? Could you advise the committee as to how you feel about surtaxes, estate taxes, freezing the top tax rate? Are there any preferences that you have so we can get a consensus?

Mr. **Anderson**. I might risk a couple of suggestions. First, I could not help but notice an article in the weekend's Washington Post which indicated that one of the 400 wealthiest people in America has paid no income taxes for the last 5 years. You know, usually we think if somebody gets out of paying taxes 1 year he has a good accountant. Here is one of the wealthiest men in the country, and he has not paid income taxes for the last 5 years.

Now one person quoted in the story says that, with the paper losses he is taking—paper losses—that the individual in question must have some smart guys advising him. And the indication is that the paper losses he is taking are, in fact, signs that his business is actually booming. And yet, these paper losses allow him to avoid taxes.

Now I am no tax expert, but I know people. And I know that when people read articles like this, they question the fairness of our present system and they wonder whether we really closed all the loopholes that we said we closed.

But the larger point that I would like to make is that I believe most people support the concept of an income tax. And if we have a generally fair tax structure, why not utilize that tax structure to raise the necessary revenues rather than going outside the structure and focus on some new tax that is clearly regressive and discriminatory?

I noticed an article by Senator Levin in the Los Angeles Times a couple of weeks ago where he commissioned an objective survey which indicated that 20 percent of Americans believe that the tax rate for the wealthiest taxpayers should be cut to 28 percent, but that 61 percent believe that the top rate should be kept at 38.5 percent. That is what it is or what it has been.

So three times as many of the people in the country in that poll would favor the 38.5 percent rate as a top rate, as compared to 20 percent, or 3 to 1, that would keep the 28 percent rate.

So I think if we are going to look someplace, that is where we should be looking rather than, as I said earlier, some specific tax that is not only regressive but hits just one section of our people.

One, we can really close loopholes. Second, we can utilize the present income tax structure, and third, we can make sure that those most able to pay, those with the very largest incomes, are those who contribute a bit more, if necessary. Not the middle- and lower-income families.

Mr. **Hammerschmidt**. Mr. Chairman, if I might respond further. While we are together on this issue, that is Chairman Howard and Chairman Anderson and Bud and myself——

Mr. **Anderson**. On tax issues we are individuals.

Mr. **Guarini**. That is where you part company.

Mr. **Hammerschmidt**. But then I am afraid that we have differences of opinion about what we do about the budget. And I hold to what I assume is the orthodox Republican position that I just do not approve of raising $19.6 billion, or whatever the figure is, in taxes. And that would be my official position.

Mr. **Guarini**. I guess the next question would be, assuming hypothetically that was a fact, then where would you be? What would your position be?

Mr. HAMMERSCHMIDT. Then you get, of course, into the broader aspect of where do you cut further in the budget. You only have two options, either raise more money or cut spending. And of course, that is a pretty broad subject.

Mr. SHUSTER. Mr. Chairman, while I am opposed to a general tax increase, if somebody put a gun to my head and I were forced to choose a tax increase, then it certainly should be a general tax increase rather than a tax increase that imposes a burden on a certain class of citizen: the highway user. Unless it were a tax imposed upon a product that was destroying American lives, and certainly not a product that would destroy the economy through a tax increase, and by that I mean a highway user.

So if there is going to be special purpose taxes, then we should look in those areas where products are destroying American lives. And I think that is sufficiently broad and yet sufficiently specific.

Mr. GUARINI. Would a surtax fit your prescription of being progressive and not pitting one industry against another or one region against another?

Mr. SHUSTER. No, and that of course is the problem with it. And obviously, I am talking about a tobacco tax, a cigarette tax. And that is the problem with it, it does hit a certain class.

But if we are going to be forced to choose a tax that is imposed upon a certain class of person, I am saying a tax on highway user, which by and large is a necessity. The highways are a necessity. They contribute to the economic development of this country. Then I am saying, this member at least, would certainly vote for an increase in the tobacco tax, a product which is destroying countless of thousands, hundreds of thousands of lives in America, as opposed to a increase tax on highway users.

Mr. GUARINI. What is the surplus in the highway trust fund today?

Mr. SHUSTER. It is about $9.6 billion, I believe; roughly $10 billion.

Mr. GUARINI. In moneys that you are not able to spend for the decaying roads and bridges and highways through our country because it is on the unified budget?

Mr. ANDERSON. We cannot touch it because it is on budget.

Mr. GUARINI. The budget process prevents you from doing that. So therefore, you are not——

Mr. ANDERSON. Even though we collected it from the people with the promise to them that every penny of it was going to go for transportation safety and construction, we are not able to touch it.

Mr. GUARINI. So you have got two problems. It is first the unified budget, and you cannot get at it. And two, you have someone nibbling at your base again. And in the meantime, you have got a massive deterioration of our transportation system in our country.

Mr. Duncan?

Mr. DUNCAN. I want to thank the panel. I would like to ask Mr. Shuster though, would you favor—and I am not for an increase in tobacco tax either—but would you favor a tax on other products of alcohol beverages, certain food items that are dangerous to health? For example, ice cream. [Laughter.]

Wheat research last year, and it was put in the Congressional Record showed that people that work in the wheat industry, in the grain industry have a higher cancer rate than those in the tobacco. Would you favor new tax on——

Mr. SHUSTER. I would say to my good friend from Tennessee, I certainly understand the point he is making. And I prefaced my comments by saying that I am opposed to tax increases. But if somebody put a gun to my head, and somebody said, you have to designate a certain product or class of products to be taxed, then I most assuredly would select tobacco and alcohol before I would select the highway users or other necessities.

Mr. DUNCAN. If it was a regressive tax, you would lose more than you gain.

Mr. SHUSTER. That certainly is an argument against it. But I would think, taken all together, and if you have this gun to my head I would stand by my position.

Mr. DUNCAN. I suppose a lot of people, research has shown, that attribute death to gasoline in automobiles in the environment.

Mr. SHUSTER. But I think few people would——

Mr. DUNCAN. You could just stretch it way on out infinitum.

Mr. SHUSTER. But I think few people would disagree our Nation's transportation system is fundamental to the economic prosperity of our country. And I doubt that anybody can make that argument for tobacco or alcohol, although I certainly am not here today arguing against tobacco or alcohol. I am simply speaking theoretically with the theoretical gun to my head.

Mr. DUNCAN. May I say, I really agree with the points all three of you make in your written statements, but maybe not addendums. But thank you so much for what you do and for being with us.

Mr. DUNCAN. Mr. Moody?

Mr. MOODY. Thank you, Mr. Chairman. It is very nice to have my former colleagues here with us. And I thought it was a very good statement. As the chairman knows, and I think perhaps the minority members know too, I have some disagreement with it, but I thought it was a very solid statement, and I applaud your work.

I totally agree with the conundrum you are in with the surplus and the user fees being built up and being locked in, in effect, to paper over budget deficits that are being run up elsewhere in government. I would like to see those freed up to meet our infrastructure needs.

I heard Congressman Shuster say he would support a designated increase in user fees to address some of our infrastructure needs; is that correct?

Mr. SHUSTER. That is correct, assuming that the trust fund was off budget and could be spent.

Mr. MOODY. I have the Wharton study that you referred to here, and I think it is a pretty good study. The study shows that people would be put on unemployment, there would be a loss of revenues to the States, and shows various negative effects of raising gas taxes for excise purposes. Don't you think that, for deficit reduction purposes, you would have the exact same effects?

Mr. SHUSTER. I would respectfully disagree with my good friend. While you would have that downside effect, and I agree with that, you would also have the other side of the coin, the upside effect of creating hundreds of thousands of transportation construction jobs.

Mr. Moody. Right, I agree.

But if these revenues were instead spent in deficit reduction, you would ease the budget pressure, which we all want to do; ease the pressure on interest rates, which we all want to do, and thereby create employment, or at least not cause unemployment.

So you are right, they would not appear in the transportation sector. It would not be highway building jobs. But presumably by getting the deficit down, we are going to get our trade deficit down, and there will be other jobs that will be helped.

It would probably take a sophisticated analysis to ascertain the net job creation, but both of them would have income lessening, and also income creating effects. I do not know what the net would be. That is my only point. I have no serious other disagreement.

Mr. Guarini. Thank you, Mr. Moody. Mr. Levin?

Mr. Levin. Thank you, glad you are here. Your comments included a reference to the trust fund nature of the tax. There have been proposals for a broad-based energy type tax to get around the issue of uneven regional impact. What do you think about that?

Mr. Anderson. Could you describe what you mean by broad-based?

Mr. Levin. For example, we discussed it last week, a BTU tax. There is a way to devise a tax on all energy sources. So you do not do it at the pump only, or you do not do it only on imports.

Mr. Anderson. And you would have all energies in there or just one?

Mr. Levin. Say you had——

Mr. Anderson. One of the problems I saw was they were kind of zeroing in on one kind of energy.

Mr. Levin. Say you had it all on energy, for example.

That's a serious proposal. I don't know how seriously it was taken here.

Mr. Hammerschmidt. Has a study been done on that? Do you have at your disposal what the effects would be, like the Wharton's study was done on the particular proposal we're discussing here now?

Mr. Levin. I think in a sense there are lots of studies. There are disagreements about the impact on the economy. There are differing attitudes about the impact on conservation which is factored into the attitudes on economic, general economic impact.

But I think it might be well if you took a look at that, because I think it avoids some of your argument, not all of it, but some of it.

Mr. Shuster. If I may respond to my friend, certainly I think it should be studied carefully. But something as broad and comprehensive I think would require an enormous groundswell of political support before it ever could be passed.

And I recall the proposal for the value added tax, and I think that was stillborn, largely because it was so broad and so new that people were so frightened of it that it never got off the ground. And I would think the fright quotient of that kind of an energy tax would be so severe that there would be an enormous political job involved in selling it.

Mr. Anderson. That might be a little more fairer than what we're talking about now, gasoline. What you are describing would hit all energy users, not just highway users. But I still don't like it because I'm not sure that hitting energy wouldn't put a cost upon our production which might even cut down on our production abilities and maybe even put some people out of work.

And I go back and I realize I'm talking as one person here. I'd rather go back to a revenue increase focusing on those of us who maybe have more ability to pay. That's why I suggested earlier, with this one article where one guy had apparently made millions and after 5 years has paid no taxes, it seemed to me that there is something wrong with our system if that's happening. And I think we ought to look at something where those of us who are making more, could pay a little bit more on a general basis, which wouldn't hurt any specific industry or production or part of the community.

Mr. SHUSTER. If the gentleman would yield further.

The Ways and Means Committee's own report of June 25 on the possible options to increase revenues, on page 56, deals with arguments against any broad-based tax on energy consumption, and goes on to indicate that such a tax would increase the cost of domestic manufacturers and decrease their ability to compete with foreign manufacturers in both the domestic and world markets. And it has three or four other reasons here as well as to why a broad-based energy tax is a bad idea—and is from the Ways and Means Committee.

Mr. LEVIN. Right. But there are three arguments listed in favor. The staff just does a first-rate job and illuminates arguments against, but also for.

Thanks very much——

Mr. MOODY. Would the gentleman yield?

One question I would like to ask before your time is up. You know, there's a proposal in the President's budget to eliminate the exemption of State and local governments from paying user fees.

The President's budget, the President's revenue package proposes to end, eliminate the current exemption of State and local government from paying user fees on gas.

How do the three of you stand on that?

Mr. SHUSTER. I could see some merits to that. I think we have to—it's worth looking at.

Mr. HAMMERSCHMIDT. I would agree it's worth looking at.

Mr. ANDERSON. It could be worth looking at.

Mr. MOODY. All right. How about the gasohol exemption? The President also recommends eliminating the gasohol exemption so you would get more user fees.

Mr. SHUSTER. This member feels strongly that it should be eliminated.

Mr. ANDERSON. I agree that it should be eliminated.

Mr. MOODY. The reason I ask——

Mr. ANDERSON. I think we should do everything we can to encourage the development of alternate fuels. But I think this gasohol exemption is the wrong approach.

Mr. MOODY. Perhaps we can work together on it. I feel that way on this committee, and working with you, maybe we can push that.

Thank you.

Mr. GUARINI. Thank you very much, gentlemen. We appreciate your testimony. Your chairman, Jim Howard, comes from New Jersey, and I understand you have 53 members on your Public

Works and Transportation Committee, and they are all together with you on this. Is that right?

Mr. ANDERSON. New Jersey does pretty good on our committee.

Mr. GUARINI. I'd like to call the Honorable Charles Rose, North Carolina, Subcommittee on Tobacco and Peanuts, *Committee on* Agriculture.

The Honorable James Jeffords from Vermont, and a joint appearance by the Honorable Stephen Neal, North Carolina, and Jim Chapman of Texas.

I saw Steve here.

Is Jim Chapman with you?

Mr. NEAL. I have not seen him, Mr. Chairman.

Mr. GUARINI. All right.

We'll proceed. Charlie.

STATEMENT OF HON. CHARLES ROSE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NORTH CAROLINA, AND CHAIRMAN, SUBCOMMITTEE ON TOBACCO AND PEANUTS, COMMITTEE ON AGRICULTURE

Mr. ROSE. Thank you, Mr. Chairman. I will be very brief.

My purpose in being here today is to give this august committee some advice, something that it certainly doesn't need at this point because you've gotten an awful lot of advice from a lot of places.

But, as a Representative from North Carolina, and as chairman of the Tobacco Subcommittee, I would respectfully ask the committee if there is any way possible that you not increase the tobacco excise taxes.

I know that the questions that follow from that statement by me immediately are what are we, as a committee, to do if we don't deal with excise taxes as one of the options. And certainly it is one of your options in the revenue squeeze that we're in.

The southeastern part of the United States, and especially our farmers in the Southeast have been very badly hurt in recent years by a series of blows, not the least of which is the low farm prices and the increased importation of foreign agricultural products. Not to mention tobacco as being one of them.

But an increase in the excise taxes would put an added burden on the farmers in the South.

Somebody asked me the other day if I didn't want excise taxes increased, what would you do? And over the years, I've gotten a lot of mail from people who come to me with super ideas on how to save the country and raise money, and I'll show you what some of my old pen pals say, that is, change the color of the money and you'll flush out billions of dollars in money that hadn't been accounted for out of the system, start to give everybody 90 days to come in and get their new darker or lighter green hundred dollar bills, or whatever it is, and you'll see some new revenue come into the Treasury immediately that way.

Second, go out and hire about 2,000 more Revenue agents to do a better job of collecting what's owed the Government now. And I know that's not particularly helpful, Mr. Chairman.

I appreciate you letting me come here today. If you don't object, I'd like my statement to be made a part of the record, and good luck in your tough decisions.

Thank you for letting me speak today.

Mr. GUARINI. Thank you. It will be made part of the record.

[The statement of Mr. Rose follows:]

STATEMENT OF THE HONORABLE CHARLES ROSE
BEFORE THE HOUSE COMMITTEE ON WAYS AND MEANS
JULY 15, 1987

Mr. Chairman, Members of the Committee, I would like to thank you for the opportunity to appear before you today to discuss my concerns with respect to any increase in the excise tax on tobacco products (cigarettes and smokeless products), and in particular what effect an increase in this tax would have on my district and the States I and other tobacco members represent.

I understand that there may be significant pressure placed upon the Committee to raise additional revenues, and that one of the options which may be considered would be an increase in the excise tax on tobacco products. While I do not feel it is appropriate for me to recommend certain revenue-raising options to your Committee, I do feel it is important that you be aware of my concerns regarding the impact of an increase in the tobacco products excise tax.

In addition to the number of individuals in my district who depend on tobacco as their primary source of income, and whose livelihoods would be adversely affected by an excise tax increase, I feel it is important to point out that the states I and other tobacco members represent have already been subjected to significant losses in federal funding for a number of programs, as well as depressed economic conditions in the farm sector generally. Further income shifts which will occur as a result of an increase in the federal excise tax on tobacco products can only have an adverse effect on the economies of the Southeastern States.

Specifically, several of the states which produce tobacco and tobacco products have lost population relative to the rest of the nation, and hence have received a declining share of formula grant funds. Further, reductions which occurred as a result of the 1980 Census in poverty estimates for most Southeastern States, has meant that most of the region has lost funds for programs where poverty is a variable. In addition, the .5 minimum allocation in many programs (i.e., the Highway Trust Fund, vocational education) has contributed to the decline in funding received by Southeastern States. Finally, last year's drought, which severely depressed agricultural production and income in tobacco-producing regions, has placed an additional burden on farmers, many of whom were already in a precarious economic condition.

For these and other reasons, such as those provided in the January 1987 Congressional Budget study which detailed the regressive effects of tobacco excise tax increase, I urge you to reject any efforts which would raise the tobacco products excise tax.

Again, Mr. Chairman, thank you for the opportunity to share my concerns with you.

Mr. GUARINI. Mr. Jeffords and also Congressman Dymally who has just joined the panel.

Welcome.

STATEMENT OF HON. JAMES M. JEFFORDS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF VERMONT

Mr. JEFFORDS. Thank you, Mr. Chairman.

I'm here on a different issue. I'm here relative to two national problems. One is the deficit, and the other is the problem of defecating rain. And now we're trying to find a combination solution here.

I have joined with Mr. Gregg and Mr. Downey and Mr. Frenzel in proposing—it's not a novel idea, it was proposed many years ago but never implemented—a tax on the emissions of sulfur dioxide and nitrogen oxide because of our frustration over the inaction of Congress on the acid rain problem.

Our proposal would require polluters to pay a substantial fee if they continue to pollute the public's air. We see more and more evidence linking sulfur dioxide and nitrogen oxide to the environmental damage. And the costs to our society are tremendous. Social costs are to those people, of course, who have their problems accentuated by acid rain. We have the damages to public buildings and monuments of over $5 billion a year, and the damage to environment, including lost forest productivity. And I invite anyone to come to Vermont and see evidence of that.

And then there are numerous other intangibles such as loss of hunting and fishing habitat, visibility impairment and decline of productivity on privately owned forest land.

What we do is take the approach, that the best way to get industry to do something is to put it in the kind of terms that they understand, and that is to say if you do what you should be doing under the Clean Air Act, and if you will reduce your emissions, then the costs imposed by this bill, would be reduced. In other words, we let the market forces dictate their action, which is the best way to get companies which are polluting to respond.

It would hold the utilities and the industries responsible for the costs that they have imposed on our society. And urge them, through economic pressures, to reduce their emissions.

Our proposal would create a three-tiered scheme and provide immediate financial incentives for industries and utilities to reduce their emissions. It would provide maximum flexibility, and I think this is important. In other words, we say you find the solution, but until you find the solution, you're going to pay for what you're doing.

Now, one of the problems we've run into, of course, is extensions on the rules and regulations with regard to the acid rain. And our proposal would try to get things moving in the direction of cleaning up their air as we have seen other nations do. But the problems which are associated with acid rain really have not been dealt with.

The emissions tax would complement the recently adopted clean coal technology program very well. It would provide a real incentive for industry to get going on developing economical retrofit technologies. It doesn't mandate them, but it says that that's one way you can go to find solutions to get out from underneath the tax burden.

Then, of course, the opponents of this measure will argue that it will harm our competitiveness in the world marketplace. But let me point out that three of our trading partners, West Germany, Japan, and Canada, all have emission control programs in place that are much more stringent than our own. So we would be just bringing them up to parity in that respect.

And, of course, the utilities will complain that the ratepayers will suffer. But all we can say is that you would be amazed if the costs are imposed how fast they will find ways to get out from under those costs.

The amount of revenue which would be gained is significant, and it would be important to this committee. The estimates that we have received from the Joint Tax Committee indicate that it could raise somewhere up to around $6 billion a year, and over the period of 1988 through 1990, could raise as much as $19 billion which, as I remember, is a figure of some significance to this committee, and would certainly enhance their ability to meet the mandates not only this year, but in the next 2 years, in order to reach our deficit reductions.

So I would urge the committee to give serious consideration to the proposal made by three of their very distinguished members, and I know that there will be many others that will support it as time goes by.

Thank you, Mr. Chairman, for giving me this time.

Mr. GUARINI. Thank you, Jim.

Mr. JEFFORDS. I would ask that my complete statement, including the details on this proposal, be made a part of the record.

Mr. GUARINI. It will be entered into the record.

[The statement of Mr. Jeffords follows:]

STATEMENT OF HON. JAMES M. JEFFORDS

Mr. Chairman, thank you for granting me the opportunity to appear before your committee. I certainly don't envy the committee in the difficult task before you.

Mr. Gregg, Mr. Downey, Mr. Frenzel and I have proposed a tax on emissions of sulfur dioxide and nitrogen oxide because of our frustration over inaction in Congress on the problem of acid rain. We need to get action on acid rain, and in the absence of a regulatory program, this market-driven approach could provide substantial health and environmental benefits while helping to reduce the federal deficit.

Our proposal would require polluters to pay a substantial fee if they are to continue polluting the public's air. We see more and more evidence linking sulfur dioxide and nitrogen oxide to environmental damage and serious human health effects. The social costs of pollution are real: health care costs for asthmatics and other citizens; damage to public buildings and monuments of over $5 billion per year; and damage to the environment, including lost forest productivity on federal lands.

These are the tangible social costs. There are numerous other intangibles: the loss of hunting and fishing habitat; visibility impairment; decline of productivity on privately owned forestland.

Industry should not be allowed to reduce their costs at our expense. Our bill would hold utilities and industries liable for the costs they impose on society. It would force them to find ways to avoid this new tax liability—and the only way to avoid that tax would be to reduce their emissions.

Our proposal would create a three-tiered tax scheme and provide immediate financial incentives for industries and utilities to reduce their emissions. It provides maximum flexibility and minimum government intervention. Those industries and utilities that have already invested in pollution control equipment would be rewarded through lower taxes, or perhaps no tax at all if emissions meet New Source Performance Standards.

One of the biggest obstacles to further emissions reductions is the phenomenon of plant life extension. As the capital costs of building new plants continues to rise, life extension of older plants becomes more and more attractive. Authors of the Clean Air Act did not anticipate life extensions. They believed that emissions would decline as new plants, meeting stringent NSPS requirements, replaced the old and dirty plants.

Our proposal would provide the economic incentive for utilities to retire their oldest, dirtiest plants, or at least scale back their use to peak operation only. Decisions would be based strictly on the bottom line. There would be no regulatory deadlines, no schedules, and most importantly there would be no incentive to litigate rather than mitigate.

This emissions tax would complement the recently adopted clean coal technology program very well. It would provide a real incentive for industry to get going on developing economical retrofit technologies. We have spent almost $400 million on clean coal projects so far, but have nothing to show for it. This is because industry has a vested interest in moving slowly. The sooner the technologies are developed, the greater the chance that industry may be required to invest in them.

Mr. Chairman, opponents of this measure will argue that it will harm our competitiveness in the world marketplace. Let me point out that three of our largest trading partners—West Germany, Japan, and Canada—all have emissions control programs in place that are much more stringent than our own.

Utilities will complain that the ratepayers will suffer. Yet many of these same companies have refused to turn back to ratepayers millions of dollars in tax windfalls created by the Tax Reform Act of 1986.

We need action to protect public health and the environment from acid rain. This approach provides maximum flexibility and minimizes government bureaucracy. It is a least cost bill that discourages long costly court challenges that continue to hamper enforcement of some sections of the Clean Air Act. And it will provide significant revenue for the treasury. The Joint Committee has estimated that this approach could provide up to $19 billion over 3 years.

Mr. Chairman, thank you for the opportunity to testify today. I urge your careful consideration of this proposal and wish you the best in the difficult task before you.

Mr. GUARINI. Congressman Steve Neal of North Carolina. Steve, we welcome you.

STATEMENT OF HON. STEPHEN L. NEAL, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NORTH CAROLINA; ALSO ON BEHALF OF HON. JIM CHAPMAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

Mr. NEAL. Thank you, Mr. Chairman.

I'd like to thank you, Mr. Chairman, and other distinguished members of this panel for hearing our views. And I would like to ask that a statement that is offered on behalf of the Honorable Jim Chapman and me be put in the record.

Mr. GUARINI. It will be made part of the record.

Mr. NEAL. Thank you, Mr. Chairman.

Mr. Chairman, I would just like to make one major point. If we raise excise taxes to meet the revenue requirements of our Budget Act, or a substantial portion of it, we will be repealing much and, in some cases, all of the tax benefits we granted low and moderate income people in last year's tax bill.

Mr. Chairman, last year's tax bill granted about $200 of tax relief to the average American family. If we were to raise enough in excise taxes to raise $18 billion, the taxes of the average American family would have to be raised by more than $300. So the entire tax break of last year would be eliminated plus there would be an increase in taxes for lower income Americans.

Mr. Chairman, excise taxes which are levied on products like gasoline, beer. wine, airline tickets, tobacco products, telephones, distilled spirits and so on, are unfair and regressive. And I certainly hope the Committee will find a more progressive way of dealing with our deficit problems.

Mr. Chairman, excise taxes would unduly penalize the typical low and moderate income American family, place the burden of reducing the deficit squarely on their shoulders. And I certainly hope the committee will find other ways to meet our obligations.

And I thank the distinguished chairman.

[The joint statement of Mr. Neal and Mr. Chapman follows:]

TESTIMONY OF
THE HONORABLE STEPHEN L. NEAL
and
THE HONORABLE JIM CHAPMAN
BEFORE THE HOUSE COMMITTEE ON WAYS AND MEANS
July 15, 1987

Mr. Chairman, distinguished colleagues of the committee, we appreciate the opportunity to appear today to address the issue of raising revenue to reduce the federal deficit.

Our position is clear and direct. Federal excise taxes should not be increased. We are not alone in this position. Earlier this session, we separately introduced H.Res. 110 and H.Res. 168 expressing the sense of the House opposing any increase in federal excise taxes as a method of reducing the deficit. To date, 72 members have cosponsored the resolutions representing a truly bipartisan group with respect to both political affiliation and geographic regions. We have attached a list of the cosponsors to our testimony for your review.

Our primary basis for opposing any excise tax is because they are regressive. Since their inception, they have been regressive. However, the extent of the regressivity is highlighted during this debate by two factors. First, the staggering amount of revenue which must be raised. Second, the proximity to passage of the Tax Reform Act.

What does it mean to the typical American family if excise taxes are increased in order to reduce the deficit?

On June 29th, the Census Bureau reported that the typical American household brought in $22,646 after taxes in 1985 representing a 0.9 increase from 1984. The average household paid $6,950, or 22 percent of income, in federal and state income, payroll and property taxes. After-tax income for white households averaged $23,484, up 0.8 percent, black households averaged $15,790, up 2.9 percent and Hispanic households averaged $17,920, down 0.4 percent.

According to Citizens for Tax Justice in its May, 1987, report entitled Meeting the Revenue Targets in the 1988 Budget, an American family with income between $20,000-30,000 will pay an additional 1.2 percent of their income toward excise taxes. The average black and Hispanic household will pay an additional 1.5 percent of their income toward excise taxes. Conversely, the household with income between $50,000-100,000 will only pay an additional 0.6 percent.

In real, disposable dollars, the typical American family gained $202 by the increase in after-tax income. Currently, it pays approximately $320 annually in federal excise taxes. An increase in the excise taxes to pay for the federal deficit will cause the American family to pay an additional $355 annually in hidden taxes.

To increase one's after-tax income due to passage of the Tax Reform Act is definitely beneficial. But in one sense, it is a windfall because Congress has the ability and has exercised that ability to subsequently increase taxes. The gains reflected in the Census Bureau's statistics more accurately reflects the blood, sweat and pain of a household working harder to make a better life for themselves.

In passing the conference report on the Budget Resolution, Congress said that in some way, we are going to take away some of the gains that were given by Tax Reform and through one's hard work. The question then becomes who do we take it away from? Excise taxes will unduly penalize the typical and low income American family. It will place the burden of reducing the federal deficit squarely on the shoulders of those families who are working the hardest to have a better life. We do not believe this to be an equitable approach to the deficit problem. We hope that during your deliberations you will reach the same conclusion.

H.Res. 168 By Chapman (D-TX)

Duncan (R-TN)
Brooks (D-TX)
Dornan (R-CA)
Emerson (R-MO)
Bunning (R-KY)
Courter (R-NJ)
Darden (D-GA)
Bliley (R-VA)
Coble (R-NC)
Dannemeyer (R-CA)
Bonior (D-MI)
Daniel (D-VA)
Bosco (D-CA)
Lancaster (D-NC)
Manton (D-NY)
Callahan (R-AL)
DeLay (R-TX)
Parris (R-VA)
Gephardt (D-MO)
Jones (D-NC)
Lagomarsino (R-CA)
Oxley (R-OH)
Ford (D-MI)
Hatcher (D-GA)
Perkins (D-KY)
Grant (D-FL)
Nielson (R-UT)
Solomon (R-NY)
Daub (R-NE)
Hefner (D-NC)
McEwen (R-OH)
Mollohan (D-WV)
Neal (D-NC)
Price (D-IL)
Robinson (D-AR)
Smith, Robert C. (R-NH)
Lott (R-MS)
Ravenel (R-SC)
Swindall (R-GA)
Tallon (D-SC)
Spratt (D-SC)
Valentine (D-NC)
Rogers (R-KY)
Williams (D-MT)

H.Res. 110 by Neal (D-NC)

Daniel (D-VA)
Hefner (D-NC)
Lancaster (D-NC)
Bliley (R-VA)
Price (D-IL)
Duncan (R-TN)
Garcia (D-NY)
Coble (R-NC)
Bunning (R-KY)
Bentley (R-MD)
Rangel (D-NY)
Dymally (D-CA)
Buechner (R-MO)
Jones (D-NC)
Perkins (D-KY)
Thomas (D-GA)
McMillan (R-NC)
Holloway (R-LA)
Ravenel (R-SC)
DeLay (R-TX)
Chapman (D-TX)
Swindall (R-GA)
McEwen (R-OH
Rogers (R-KY)
Valentine (D-NC)
Tallon (D-SC)
Kolter (D-PA)
Towns (D-NY)

Mr. **Guarini**. Thank you for your testimony.

Congressman Mervyn Dymally of California, welcome.

STATEMENT OF HON. MERVYN M. DYMALLY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA, AND CHAIRMAN, CONGRESSIONAL BLACK CAUCUS

Mr. **Dymally**. Thank you, Mr. Chairman.

Mr. Chairman, how much time do I have?

Mr. **Guarini**. Five minutes.

Mr. **Dymally**. I need—OK, 3½

Mr. **Guarini**. Do you need extra time? We'll negotiate.

Mr. **Dymally**. No, thanks.

Mr. Chairman, as the representative for thousands of working class Americans in Los Angeles County, and as chairman of the Congressional Black Caucus, I watched with interest the passage of the tax reform bill of 1986 as a means of affording a measure of relief for poor people.

The most attractive part of that legislation was the removal of more than 4 million of the working poor from the Federal tax rolls, along with a reduced tax burden for other low income American families. The byword for the 1986 tax legislation was fairness and, as law, it has been fair, at least for the low brackets.

But now, in 1987, Congress is looking to take back what it gave to the poor in 1986. The revenue shortfall and immense budget deficit looming over this Congress have sent many of fellow members in a frantic search for more revenue. And for many reasons, because it's easy, because it seems to be nickel and dime taxation, or because the people who are hurt by it are not organized to protest, too many are looking to a rise in excise taxes. This, Mr. Chairman, despite clear evidence that this method places the burden on those least able to bear it.

The regressive nature of excise taxes has been well documented. For our purposes, this conclusion has been confirmed in the preliminary draft of a major report on revenue options prepared for the chairman of the Congressional Black Caucus and to be released next week. And, Mr. Chairman, I shall leave a copy for the committee's review and record. The task force report demonstrates precisely who is paying when excise taxes are increased.

In general, the proposed increases in excise taxes would be approximately twice as large for families with incomes between $10,000 and $20,000, compared to families with incomes of $50,000 or more. According to a 1987 staff working paper report of the Congressional Budget Office, families with incomes of less than $5,000 spent 17 percent of their income on gasoline compared with just over 2 percent for families with incomes of $50,000 or more. An increase in the tax on tobacco would raise taxes as a percent of expenditures by more than twice as much for families with incomes below $10,000 than for families of $50,000 or more. And any increase in excise taxes for telephone service or alcoholic beverages would also hit low income families disproportionately.

The interests of my constituents and that of the Congressional Black Caucus in this issue are enormous. Approximately 7.2 million poor families lived in this country as of 1985, and although numerically there are more whites in poverty than minorities, the proportion of blacks and other minorities in poverty is greater than that of whites. But for all poor families, even a modest increase in excise taxes will take more than all of the tax relief afforded them in the 1986 tax bill. These increases, Mr. Chairman, will cost the poor five times as much, nearly $2 billion, as they would receive in income tax cuts from the Tax Reform Act of 1986. This will considerably magnify the incidence, prevalence, and the enormity of poverty in the United States.

The task force report is protesting an increase in excise taxes without offering other alternatives for raising revenue. While the excise tax is, by its nature, the most regressive of taxes, the Federal income tax is the most progressive. Several measures can be taken which improve the progressivity of last year's tax reform bill.

For example, while the Tax Reform Act of 1986 brought fairness to the lower brackets, it was arguably too fair, in my judgment, to the higher brackets. Speaker Wright has suggested freezing the income tax rate for high income individuals in the top bracket at 38 percent, rather than allowing it to fall to 28 percent. This measure alone would bring in more than $22 billion, or $2.7 billion more than the revenue we are seeking. As another idea, the top estate tax rate is scheduled to be reduced from 55 to 50 percent. If this rate is frozen at 55 percent, we can save $2 billion over the next 5 years. And, finally, closing the tax loophole which allows wealthy individuals to sell stock to employee stock ownership plans and escape taxation would provide another $5 billion over 3 years.

Mr. Chairman, I urge careful attention to the report of this task force. A committee which distinguished itself last year as a bastion of fairness cannot and should not renege on that commitment. Abandoning moral responsibility in pursuit of short-term fiscal solutions cannot be and should not be the goal of this committee or this Congress.

Thank you very much, Mr. Chairman. I shall leave a draft copy of the report.

[The report follows:]

A TASK FORCE REPORT

ON

AN EVALUATIVE ANALYSIS OF THE POSSIBLE IMPACT OF FEDERAL EXCISE TAXES ON THE POOR, INCLUDING BLACKS AND OTHER MINORITIES

PREPARED FOR
CONGRESSMAN MERVYN M. DYMALLY
CHAIRMAN
CONGRESSIONAL BLACK CAUCUS

JULY 1987

I. Introduction

It has been amply demonstrated that blacks and other minorities have accepted their full responsibilities as citizens of the United States including that of paying their fair share of taxes and subscribing to other revenue bearing measures. Because of the general low socio-economic status of blacks and other minorities in the United States, it is of significance that taxes and other revenue raising measures be somewhat progressive and be based upon the ability to pay.

Approximately 200 proposals have been submitted to the 100th Congress geared to raise revenue and to reduce the federal deficit. This report, however, will address itself mainly to one category of these proposals and, as a consequence, will make an evaluative analysis of the possible impact of federal excise taxes on the poor, including blacks and other minorities. This analysis will include the following:

1. An analysis of the major Federal Excise Taxes in terms of regressivity;
2. An analysis of the socio-economic status of blacks and Hispanics in terms of the possible impact of the Federal Excise Tax on these minorities;
3. A discussion of selected less regressive revenue raising options.

The Congress of the United States, after approving a $1 trillion spending plan, is currently attempting to raise approximately $19.3 billion in taxes for 1988 and $64.3 billion over the next three years. The process calls for the recommendation of specific revenues from the tax writing committees of the U.S. House of Representatives and the U.S. Senate. As a consequence, considerable interest has been shown in the utilization of excise taxes as a means of raising the above referenced amount and, in the process, reducing federal budget deficits. Because of the recency of the tax reform legislation of 1986, many legislators are somewhat reluctant to seek further changes in increased tax rates. Despite the fact that if excise taxes are relied upon to raise the full $19.3 billion in taxes for 1988, these taxes will virtually wipe out the average tax reduction received by low and middle-income tax payers under last year's tax reform legislation. It will also keep intact most of the tax cuts for upper-income people. Moreover, studies have shown that people tend to be more concerned with tax fairness than with tax rates and, therefore, the equitable and fair distribution of revenue increases rather than changes in tax rates per se.

The present concern with excise taxes does not seem to comply with fairness because of its regressivity and because they are hidden, thereby challenging the much valued openness in government. If, therefore, Congress raises excise taxes as currently discussed, the poor will lose twice what they gained by the tax reform of 1986. The American people will, therefore, be opposed to a tax revenue approach that secretly raises money on the backs of the poor.

According to Charles E. McLure, a former deputy assistant secretary for tax policy at the U.S. Treasury Department, in a study for the American Enterprise Institute:

> Resort to excises as an important source of revenues is usually associated with developing countries that lack the administrative capacity to impose better taxes...The Federal government of the United States clearly does not fit that description.[1]

It is of significance that the average U.S. household currently pays $370 annually in 1986 dollars under current federal tax law for federal excise taxes. Additionally, every state has imposed some excise taxes. In 1986, total federal, state, and local excise taxes amounted to $790 per household.

Federal excise taxes are scheduled to rise by more than 75 percent in the current proposal now discussed with the different components distributed as follows:[2]

Gasoline	increase of	111 percent
Cigarettes	increase of	200 percent
Beer	increase of	306 percent
Table wine	increase of	1733 percent
Distilled spirits	increase of	20 percent

The major excise taxes of energy, distilled spirits, beer, wine and tobacco will herein be examined in terms of their impact on the poor.

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[1] Quoted from statement of Rev. Robert J. McEwen, Chairman of Consumers Opposed to Secret Taxes of June 4, 1987.

[2] See Federal Excise Taxes: Cost to Average American Households, prepared for the COST Coalition by Quick, Finan and Associates, p. 2.

II. The Regressive Aspects of the Major Federal Excise Taxes

A. Energy Taxes

The United States depends on foreign sources for about 19 percent of its total energy and for about 29 percent of the oil it consumes. An energy excise tax must, therefore, be weighed against these facts. In addition, energy taxes constitute a larger proportion of family incomes for low income tax payers who spend a high percentage of their meagre income on energy. An increase in fuel oil will exert a particular hardship on low income people in both rural and urban areas particularly during the Winter months. Moreover, an excise tax on foreign petroleum might very well be in violation of the rules of the General Agreement on Tariffs and Trade (GATT) particularly if a higher tax is levied on imported oil than on domestic oil. GATT regulations specify that taxes on imported products from any of the member countries must not be more than those applied to some domestic products.

With specific reference to gasoline taxes, it is felt that higher gasoline taxes would increase the tax burden on a commodity which is already heavily taxed. In addition to the 9 cents per gallon federal excise tax on gasoline and state excise taxes which average about 14 cents per gallon, companies dealing with the production and distribution of oil and oil products pay many other kinds of federal, state and local taxes. This includes severance and other production taxes and property taxes in addition to taxes such as the windfall profit taxes specifically applied to the petroleum industry. Moreover, per capita gasoline consumption in the southern and western states is significantly higher than in other regions of the country. As a consequence, consumers in the West and South would bear a disproportionately large share of the burden of additional federal motor fuel taxes with a high proportion of the poor and blacks residing in the South. The gasoline excise tax also has been shown to be highly regressive with gasoline consumption constituting a much higher percentage of the budets of low income families than of high income family budgets. Almost one fourth of the gasoline tax is borne by low to moderate income households while only 5 percent is borne by high income households. Additionally, a Congressional Budget Office report indicated that a gasoline tax increase as scheduled would cost families in the $10,000 to $20,000 income range about twice as much, relative to their income, as families with incomes over $50,000. More specifically, according to a study by Citizens for Tax Justice,

> If Congress were to meet its budget targets with a gasoline tax hike, families earning less than $10,000 would have to shell out 25 times as high share of their incomes in increased taxes as would rich people.[3]

In a similar vein, the same study refers to overall energy consumption as "extraordinarily regressive" and states further that,

> Because overall energy consumption is distributed much like gasoline consumption, the effects of an oil import fee would mirror those of a gasoline tax hike -- except that the magnitude would be almost three times as great for every

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[3] Citizens for Tax Justice, Meeting the Revenue Targets in the 1988 Budget: Will Tax Reform Be Extended or Undermined, Washington, D.C., May 1987, p. 5.

dollar collected in import taxes. Thus, poor families would lose more than 5 percent of their incomes to higher oil costs.[4]

B. Tobacco and Excise Taxes

The proposed increase in the excise tax on tobacco is generally considered to be the most regressive of all of the tax increases considered. As a percentage of income, the tobacco excise tax is 15 times higher for low income, under $5,000 families than for high income, over $50,000 families.[5] More specifically, whereas tobacco excise taxes average approximately 0.275 percent of the total income of all tax payers, in the lowest income class, the tax averages 1.3 percent of income. On the other hand, in the top income class, it averages only 0.035 percent of income. Moreover, 28.8 percent of tobacco excise taxes are paid by low to moderate income earners, thereby constituting a higher percentage than for any other tax except beer with 29.0 percent.[6] This regressivity will be incurred inspite of the fact that doubling this tax from 16 cents to 32 cents per pack will yield only $2.9 billion additional federal dollars. This doubling of the tax will also contribute to a loss of 28,500 jobs in the U.S. tobacco industry, resulting in the further untold suffering of more low income people who depend on the tobacco industry for their livelihood. As a case in point, R.J. Reynolds plans to cut 2,800 tobacco-related jobs by the end of 1987 to strengthen its competitiveness in the face of declining cigarette consumption. By April, 1987, jobs in tobacco manufacturing had decreased by 1,200 in North Carolina to 23,000 for a drop of 4.9 percent over the previous year.[7]

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[4] Citizens for Tax Justice (May 1987), p. 6.

[5] See Congressional Budget Office, The Distributional Effects of An Increase In Selected Federal Excise Taxes, January, 1987.

[6] The Policy Economics Group of Peat, Marwick, Main and Co., An Analysis of the Regressivity of Excise Taxes, May 1987, p. 21.

C. Liquor

As in the case of the tobacco industry, the liquor industry has shown somewhat of a decline in consumption with an apparent decrease of 6 percent since 1985. This is seemingly attributable mainly to a 19 percent increase in Federal excise tax which took place as recently as 1985. The liquor industry has experienced 16 fewer distilled spirits bottlers and producers in 1986 than in 1978. Moreover, 28 percent of the liquor manufacturing jobs available in 1978 were lost by 1984 with a further 5.4 percent job loss in 1985.

D. The Beer Industry

The future of the beer industry, now slowly recovering from declining sales, will be sorely threatened with an increase in federal excise taxes. This industry now employs more than 39,000 people with supporting jobs for more than a million and a generation of approximately more than $114 billion in economic activity in the United States.

Doubling the excise tax on beer from $9 to $18 per barrel would cost the economy of the United States about 9,000 jobs with about 6,400 jobs lost in the brewing industry. On the other hand, tripling the excise tax on beer from $9 to $27 per barrel would cost the economy of the United States an estimated 18,400 jobs with a specific loss of approximately 13,000 jobs in the brewing industry.

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[7] News and Observer, June 4, 1987.

Any of the above decisions will increase the ranks of the unemployed and the poor, including minorities and blacks in the United States, and significantly increase the regressivity of excise taxes on beer which now impose the heaviest burden on lower and middle-income households. As a consequence, the federal excise tax on beer is now regarded as one of the most regressive of all taxes, since beer has become institutionalized in the United States as the beverage of choice to lower income and working middle income Americans.

E. The Wine Industry

A similar pattern, as discerned in the beer industry, is found in the wine industry. From 1984 to 1986 the consumption of table wine produced in the United States decreased by 6 percent, from 283 million gallons to 267 million gallons, with a consequent abandonment of 79,000 acres of California vineyards alone in 1986. As in other cases, the excise tax increase on table wine will be passed on to the consumer and, as in other cases, will also fall particularly hard on lower and middle income consumers with a consequent 20 percent to 30 percent loss in sales volume and an estimated 34,000 loss in jobs in wine and associated industries. This further exacerbates the plight of the poor, including blacks and other minorities.

III. Congressional Budget Report

A staff working paper for the Congressional Budget Office on "The Distributional Effects of An Increase In Selected Federal Excise Taxes" shows the following as they relate to the regressivity of excise taxes on the seven commodities: beer, wine, liquor, tobacco, gasoline, air fare and telephone service but with specific reference to the first five, specifically alluded to in this study[8]:

1. An increase in the excise tax on tobacco would be the most regressive of all the tax increases taken into consideration.

2. In measuring the distributional effects relative to family income, it was ascertained that an increase in any of the taxes, except the airline ticket tax, would be noticeably regressive. Additionally, the average increase in taxes as a percentage of total income would be approximately twice as large (more than three times as large in the case of the tax on beer or tobacco) for families with incomes between $10,000 and $20,000 compared to families with incomes of $50,000 or more.

3. Families with incomes of less than $5,000 spend 17 percent of their income on gasoline compared with just over 2 percent for families with incomes $50,000 or more. Families in the lowest income class spend about 12 percent of their income on telephone service; families in the highest income class spend just under one percent.[9]

4. Families with incomes under $10,000 account for a much larger share of tobacco and telephone expenditures and a slightly larger share of beer expenditures compared to their share of total expenditures. Conversely, for all commodities, except wine and air fare, the share of

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[8] Congressional Budget Office, The Distributional Effects of an Increase In Selected Federal Excise Taxes, January 1987, pp. 1-35.
[9] Congressional Budget Office, January 1987, p. 8.

expenditures for families with incomes of $40,000 or more is less than their share of total expenditures.[10]

5. As a percentage of income, excise taxes are highest in the lowest income class for all seven types of expenditures.[11]

6. Tobacco excise taxes, as a percent of income, are less than one-fourth as large for families in the highest income class compared to families with incomes of $10,000 to $20,000.[12]

7. Families with incomes of less than $10,000 pay at least 10 percent to 12 percent of excise taxes on gasoline and alcoholic beverages. These families pay about 13 percent of the telephone excise tax and about 15 percent of the tax on tobacco. Families in the highest income class pay between 20 percent and 25 percent of most excise taxes, except those for airfare (31 percent) and tobacco (only 14 percent).[13]

8. An increase in the tax on tobacco would raise taxes as a percent of expenditures by more than twice for families with incomes below $10,000 than for families of $50,000 or more.[14]

9. The share of the tax increase for families with incomes of less than $10,000 would be the largest for tobacco taxes and the smallest for airfare taxes. Families with incomes between $10,000 and $30,000 would also fare the worst under a tobacco tax increase and fare the best under an airfare tax.[15]

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[10] Congressional Budget Office, January 1987, p. 12.
[11] Congressional Budget Office, January 1987, p. 18.
[12] Congressional Budget Office, January 1987, p. 18.
[13] Congressional Budget Office, January 1987, p. 23.
[14] Congressional Budget Office, January 1987, p. 28.

IV. The Socio-economic Status of Blacks in the United States

The impact of increased federal excise taxes on the poor, on blacks, and other minorities cannot be fully assessed unless an evaluative analysis is made of the socio-economic status of blacks in the United States.

In 1980, blacks made up 12.1 percent of the adult civilian labor force, 11.4 percent of those employed, and 22.4 percent of those unemployed. At that time, black adults experienced a rate of unemployment that doubled their percentage in the labor force and a rate of employment that was below their labor force share. Moreover, non-whites, in general, and blacks, in particular, are under-represented in the fastest growing high wage occupations such as computer specialists, engineers, accountants, managers, and administrators. Consequently, most blacks who work do so in jobs with low wages, with limited job security and advancement.

The employment outlook of black teenagers is even more critical and has been for approximately a decade. In 1980, the unemployment rate of black teenagers was 35.8 percent, while that of white teenagers was 15.5 percent. The rate of participation of black teenagers in the labor force is also much lower than those of white teenagers.

An analysis of current population reports by the Bureau of Census entitled "Money Income and Poverty Status of Families and Persons in the United States: 1985", throws further light on the socio-economic status of blacks and other minorities in the United States.

The estimated median income for white families in 1985 was $29,150 as compared to the Spanish speaking median family income of $19,030 and the median income of black families of $16,790. These data indicate that the income gap in 1985 between white, black and Hispanic incomes still remains wide.

This differential persists in real per capita income. Real per capita income in 1985 in the United States was $11,010 with the per capita income of whites estimated at $11,670 while that of blacks was $6,840 and persons of Spanish origin was estimated at $6,610.

Taking into consideration that the poverty threshold for a family of four in 1985 was $10,989, it is of significance that 33.1 million persons or 14 percent were found to be below the poverty level in 1985. More specifically, in 1985, 22.9 million whites or 11.4 percent were in poverty as contrasted with 8.9 million blacks or 31.3 percent, and 5.2 million Spanish origin persons of mixed racial origins or 29.0 percent.

Additionally, the poverty rate among children under 18 years old was 20.5 percent in 1985. The rate among black children was 43.4 percent and Spanish origin children, 39.9 percent.

It is of additional significance that the number of poor families in 1985 was 7.2 million and that almost one-half of these, 3.5 million, had a female head of household with no husband present. The poverty rate among families in this same year was 28.7 percent.

For the purpose of this study, it is important to note that regionally, the poverty rate is highest in the South with the implication that additional increases in federal excise taxes might conceivably have a more adverse effect on this region than any other region in the United States.

Numerically, therefore, there are predominantly more whites in poverty in the United States than there are blacks and other minorities. The proportion, however, of blacks and other minorities is greater than that of whites. All racial ethnic groups who are poor, therefore, will suffer with varying degrees of intensity if there are further increases in federal excise taxes.

Additional indicators of low income prevalence can be gleaned from the current minimum wage. In the United States, 6.7 million men and women earn the minimum wage of $3.35 an hour or less. Approximately 70 percent of those who are paid the minimum wage are women. An increasingly high proportion of these women are household heads who support families on these low wages. A significant proportion of these women are black.

It is significant that if one works 40 hours per week, a minimum wage worker will earn $6,968 annually. This is $400 below the poverty line for a worker with a single dependent and $1870 below the poverty line for a family of three. Therefore, the total number of workers who are living below the poverty level increased from 6.7 million in 1975 to 9.1 million in 1985.

The ranks of the low income are also augmented by the decreasing number of black farmers in the U.S. In 1920, there were 925,710 black farmers in the U.S. In 1982, however, there were fewer than 33,250 black farmers. Additionally, between 1978 and 1982, all farms in the U.S. declined less than one percent while black operated farms decreased by about 10 percent. Moreover, between 1980 and 1986, the number of FMHA ownership loans to all farmers in the United States declined by 68 percent, while the number of owernship loans to black farmers decreased by 91 percent.

V Options to Federal Excise Taxes

The above indicates that even modest increases in excise taxes will take more than all of the tax relief afforded by the 1986 tax reform bill, which gave tax payers with incomes of less than $19,000 an average tax reduction of $39. More specifically, revenue raising proposals in Congress to increase federal excise taxes could conceivably cost the poor five times as much -- nearly $2 billion -- as they would receive in income tax cuts from the 1986 Tax Reform Act. An increase in excise taxes would be in conflict with and counterproductive to the fairness achieved by the 1986 tax reform legislation. As a consequence, the tax will magnify, in geometric proportions, the plight of the poor, including a numerical majority of whites and a proportional majority of blacks and other minorities.

Federal Income Tax is considered to be the most progressive and the least regressive of all of the traditional revenue raising devices. The "sense" of Congress in drafting and approving the 1986 Tax Reform Act was that although Federal Income Tax was moved to a higher level of progressivity, there was still room for improvement.

The following options must, therefore, be seriously considered:

1. The Speaker of the U.S. House of Representatives, James Wright, is a staunch advocate of one such change as a revenue raising option. Speaker Wright advocates freezing the income tax rate for high income individuals in the top bracket at 38.5 percent, rather than allowing it to fall to 28 percent next year, as scheduled. This approach, if taken, can avert approximately $22 billion in 1988 tax cuts for the very wealthy -- more than the $19.3 billion in revenue now sought.

2. The top corporate rate should be cut to 38.5 percent rather than to 34 percent as proposed. This proposed 38.5 percent rate is substantially lower than the 46 percent rate applied to taxable income of $100,000 or more that was in effect until June 30. This rate would yield approximately $4 billion in 1988 and $14 billion in three years.

3. In 1988, the top estate tax rate is scheduled to be reduced from 55 percent to 50 percent. If this rate is frozen at 55 percent, revenue losses over the next five years of $2 billion will be avoided.

4. A loophole in the 1986 Tax Reform Bill allowed estates to escape taxation by selling stock to employee stock ownership plans. If this change is made, $5 billion in revenue can be raised over three years.

TASK FORCE MEMBERS

Stanley H. Smith, Ph.D.
Task Force Chairman
President, Caribbean American Research Institute

John Vincent Egan, Ph.D.
Assistant Professor of Economics
Howard University

Lenneal Henderson, Ph.D.
School of Public Administration
Howard University

Vincent R. McDonald, Ph.D.
Chairman
Department of Economics
Howard University

Randall E. Echols
Special Assistant
Congressman Mervyn M. Dymally

Mr. GUARINI. I thank you for your testimony.

Mr. Rose, do you feel that all excise taxes being regressive that you would be disinclined toward not just tobacco but the others that were mentioned?

Mr. ROSE. Yes, sir.

Mr. GUARINI. All right. And how do you feel, Jim? You haven't—you talked about acid rain, and I can understand where you would be very concerned about that. But what positive suggestions do you have concerning the direction we should go if you've come to any conclusion on raising the $19.3 billion?

Mr. JEFFORDS. I'm sorry. Are you referring to my proposal on acid rain, or are you referring to the general excise tax situation?

Mr. GUARINI. You said acid rain should collect $6 billion.

Mr. JEFFORDS. That's correct.

Mr. GUARINI. Over a 3-year period?

Mr. JEFFORDS. No. That's over a—that's 1-year period. Over a 3-year period, it would be $19 billion according to the Joint Tax Committee.

Mr. GUARINI. And without any anticipated displacement of employment?

Mr. JEFFORDS. We think probably it would enhance employment rather than displace it for the immediate manufacturing of the various requirements of the bill.

No, I don't—my own feeling is it wouldn't have any employment displacement.

Mr. GUARINI. How do you gentlemen feel about a surtax? It's progressive. You can kick in at any income level. It certainly doesn't pit one industry against another. It's not regional. It doesn't target. You could repeal it easily. And it doesn't hit the poor people.

Do you have any particular——

Mr. JEFFORDS. Are you talking about a corporate surtax?

Mr. GUARINI. Individual and corporate 5 percent surtax to raise $20 billion a year.

Mr. JEFFORDS. Well, I could probably give you a standard Republican response to that, but I will let my other friends comment. I think——

Mr. GUARINI. Well, let me, before you answer, say that in 1984, President Reagan asked for a standby surtax, and we didn't give it to him. So if we had it as a standby tax, that was one of his proposals in 1984. And I might say that in 1968, this Government passed a 3-year tax to last during the final years of Vietnam in order to finance the end of the war. And that had been managed well, administered well. It was a 10 percent tax at that time, and it had a sunset.

So we did have an experience based on the surtax.

Do you feel disinclined toward a progressive tax of that nature?

Mr. JEFFORDS. Well, my own personal feeling is that I would rather look at other options. I think that some of the changes that we made in the 1981 tax bill, especially relevant to the estate tax proposal we had here, I think that we could also raise $2 or $3 billion a year by going to a 0.9 percent fee on imports to take care of some of our import related problems.

There are other options that I would look at before I would go to a surtax option.

Mr. GUARINI. Would an import oil tax hurt Maine?

Mr. JEFFORDS. No, Vermont—yes, it would. I'm not talking about an import tax on oil. I am talking about across-the-board proposal which I think is in the trade bill at least giving the administrative branch, the executive branch the opportunity to do that.

But, in my mind, that kind of a proposal would assist us in some of the trade-related matters which could raise up to over $3 billion a year by a 0.9 percent. I prefer that for assisting ourselves in some of the problems we had that are trade related, whether it be TAA or whatever.

Mr. GUARINI. Does the panel agree with Mr. Dymally that we shouldn't hurt the very people that we tried to help when we were passing tax reform, that we took 4 to 6 million people off the tax rolls that could least afford to pay income taxes, and now we would be, by an excise tax, targeting those very people we intended to help?

Mr. ROSE. Mr. Chairman, I would like to associate myself with the remarks of my colleague from California, Mr. Dymally, and congratulate him and his panel for bringing forth this report.

I think it will be very helpful, and it certainly follows my thinking.

Mr. JEFFORDS. Without necessarily agreeing with everything that my good friend from California said, I do agree with the general thrust that we should not add additional burden to those that we were trying to relieve in the last tax provisions.

Mr. GUARINI. Steve?

Mr. NEAL. Yes. Mr. Chairman, I certainly agree, and I think our distinguished colleague made the point better. I tried to make the same point in my own testimony.

I also would like to comment on the surcharge. As I understand it, a 5 percent individual tax surcharge, 5 percent corporate tax surcharge, which would be applied to tax payments, not to income, and therefore would really be equivalent to a 1 percent rise in tax rates.

Mr. GUARINI. Less than 1 percent.

Mr. NEAL. Would raise $10 billion from individuals this year, $51 billion over 3 years, and would raise $3 billion from corporations, $12 billion over 3 years. I frankly find it hard to disagree with that as a way of raising some needed revenue.

Remember, I said $13 billion in the first year. We're only $5 billion then away from the goal that we need to meet. So I certainly——

Mr. GUARINI. It's a clean and quick way to get revenues without it being inflationary.

Mr. NEAL. It seems not inflationary, not unfair, and not very burdensome. I cannot see how anyone frankly could be hurt very much by a 1 percent increase in taxes.

Mr. GUARINI. Yes. Charles, tell me when a tax goes on cigarettes, the tax just doesn't get passed down to the public as an increased price in the product? Isn't there also an additional add-on that the distributor and manufacturer adds so that the cost to the public is even more than say the 8 cents or 16 cent tax?

Mr. Rose. That's frequently the case, and you're absolutely right. It is an added burden.

Mr. Guarini. And it is inflationary, whether you're talking about cigarettes or beer or gasoline or anything else?

Mr. Rose. Exactly.

Mr. Dymally. Mr. Chairman, and I think it gives incentive to some States to do a sort of matching increase. The Feds go up *x* percent and we get increased by *y* percent for revenues because we have established the precedent here, we have established a pattern, and after all it is just a sin tax.

The other argument is that it is selective. Not everyone smokes and drinks. But not everyone eats candy either.

Mr. Guarini. Right.

Mr. Dymally. Or ice cream. So you can't call a tax a selective tax. It hits the——

Mr. Guarini. There's a large fairness question involved, isn't there?

Mr. Dymally. Yes.

Mr. Rose. Mr. Chairman.

Mr. Guarini. Yes.

Mr. Rose. My colleague from South Carolina, Mr. Robin Tallon, has brought a letter from a former member of this panel, the Honorable Carroll Campbell, now the Governor of South Carolina, and he would like to ask your permission to have that made part of the record.

Mr. Guarini. Yes. Robin, would you like to make a statement while you're here?

STATEMENT OF HON. ROBIN TALLON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF SOUTH CAROLINA

Mr. Tallon. Mr. Chairman, thank you.

I would just like to associate myself with the testimony and remarks of my chairman, Congressman Charlie Rose, and as Congressman Rose indicated, I have a letter from our distinguished Governor, the Honorable Carroll A. Campbell, who was a former member of this committee, that I would like to submit for the record.

This letter expresses his urging the committee to not consider any excise tax on tobacco products.

Mr. Guarini. It will be put into the record. He was one of the most distinguished members of our committee, and we remember him very well.

Mr. Tallon. Thank you very much, Mr. Chairman.

Mr. Guarini. Thank you.

[The letter from Governor Campbell follows:]

State of South Carolina

Office of the Governor

Carroll A. Campbell, Jr.
Governor

Post Office Box 11369
Columbia 29211

July 14, 1987

Honorable Dan Rostenkowski
Chairman
Committee on Ways and Means
U.S. House of Representatives
Washington, D.C. 20515

Dear Danny:

As Governor of one of the largest tobacco producing states, I feel it is incumbent upon me to urge that the tobacco excise tax, now under consideration by the Ways and means Committee, be rejected as an option in dealing with budget reconciliation.

An additional excise tax of any kind on tobacco would have a markedly detrimental effect upon the agricultural economy of South Carolina. As you know, the tobacco industry in South Carolina is of primary importance to much of our state's rural community. Every tax increase on tobacco products adversely affects South Carolina growers, warehousemen, distributors, bankers, and the whole stream of commerce in my state.

Again, I call upon you not to balance the budget on the backs of the South Carolina tobacco farmers when agriculture is experiencing the worst of times in recent history.

With best personal regards, I am

Sincerely,

Carroll

Carroll A. Campbell, Jr.
Governor

CACJr/nm

Mr. DUNCAN. Thank you, Mr. Chairman.

I would like to welcome our colleagues. I think on the tobacco subject we have had testimony in the past that an increase in tobacco tax would almost affect the poor a little bit more than the wealthy because the wealthy you can charge $5 for tobacco, and they are going to buy theirs just the same; but the lower income people, they cannot.

Do you find that to be true, Charlie?

Mr. ROSE. Yes, sir. I think that is a good observation.

Mr. DUNCAN. You are not going to stop the wealthy from smoking, but you might the poor man who has the same right.

Mr. ROSE. That is right.

Mr. DUNCAN. He should have the same right of choice if he wishes.

Mr. ROSE. Absolutely.

Mr. DUNCAN. I have nothing further to add, Mr. Chairman. Thank you.

Mr. GUARINI. Mr. Levin.

Mr. LEVIN [presiding]. Welcome. Let me just, as you leave, make this comment. I hope that the constituents of Mr. Rose and my friend Robin Tallon and my former Banking Committee colleague Mr. Neal realize that you have, I think, an extraordinarily difficult task here persuading the balance of your colleagues. This is not the time to go into all aspects. Your testimony has been very cogent.

You have discussed, endlessly perhaps, health aspects that enter into these discussions, but we will carry that on. There will be a vigorous debate within this committee on all of your proposals. Mr. Tallon's letter from the Governor will be entered into the record.

Mr. ROSE. Mr. Chairman, could I just state for the record that our colleague from Georgia, Mr. Lindsay Thomas, is here with us and our colleague from North Carolina, Mr. Martin Lancaster, just to lend us moral support. We urge the panel to do what is right, and we know that you will.

Mr. LEVIN. Thank you. I can say from practical experience that both Mr. Lancaster and Mr. Thomas will lend their moral support. It will be vigorous support with the rest of you on the floor.

Thank you very much.

Mr. NEAL. Mr. Chairman.

Mr. LEVIN. Yes, Mr. Neal.

Mr. NEAL. I do not remember who made this statement in the Democratic caucus this morning, but I was particularly moved by it and I would like to share my recollection of it with you, if I might. I will not have exactly, but the general idea was this. I believe it was one of our colleagues from Michigan, as I recall. He made the point that there are many, many Americans of moderate and low income who may not have an awful lot to look forward to, and among the things that they look forward to, no matter what you or I or others may think of it, among the things that are often the most pleasurable to a lot of people are maybe a beer or two after work and a cigarette and cigar, maybe a little drive in the country in the car and so on. These are among the pleasures of many average Americans, and these are the pleasures that would be taxed—I think unduly—by excise taxes. So I would just leave with that.

Mr. DYMALLY. Mr. Chairman, I just want to make one observation. There is a tendency sometimes to make a moral judgment about good and bad and apply taxes to the bad. If we are going to do that, we ought to tax sugar and salt.

Mr. LEVIN. Mr. Duncan brought in ice cream, which I thought was a low blow myself.

Thank you very much, Mr. Dymally, and my former colleague on the Banking Committee, Mr. Neal.

Now, if we might call in a group with each giving separate testimony, Mr. Beilenson, Mr. Glickman, Mr. Rahall, Mr. Solomon, Ms. Schneider, and Mr. Kasich—is he here?

Welcome to all of you. I understand that Mr. Beilenson is chairing the House.

Mr. BEILENSON. He is supposed to be, Mr. Chairman, but he obviously isn't.

Mr. LEVIN. A person of immense talent. How you are doing both, I am not sure, but welcome to each and every one of you. If we might, we will start with Mr. Beilenson and then go in the order that I tried to call you, in the order of your appearance. I am not sure we made it, but we tried.

Mr. Beilenson.

STATEMENT OF HON. ANTHONY C. BEILENSON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. BEILENSON. Thanks very much. Along with my colleagues here, I appreciate very much the opportunity to testify on some ways to raise additional revenue as were called for by the fiscal year 1988 budget resolution.

As the author of bills to increase excise taxes on gasoline, cigarettes, and wine and beer, I greatly appreciate having the chance to talk about the merits of those proposals with the members of this committee. But before I do, I have two other suggestions, if I may, about raising taxes.

First, regardless of the type of tax increases this committee recommends, I want to urge in the strongest terms possible that those increases be permanent. Although your reconciliation directive calls for raising specific amounts of revenues in 1988, 1989 and 1990, I would hope that your recommended provisions continue to raise revenue beyond those years. If, for example, you report any excise taxes, I would urge that they not expire after 1990. Or if you decide to retain the 1987 individual tax rates, I would urge that you retain them permamently, not just for 3 years. I hope that you will reject the idea of a surtax since that very name implies that it is temporary.

As you know, the need for additional revenues to bring the Federal deficit under control is not going to suddenly disappear 3 years from now. In fact, of course, as you heard again this morning, it is going to get more difficult.

If the taxes you recommend expire in 1990, then Congress is going to be faced again with voting for tax increases at that time. In addition, a temporary tax increase would also hold out false hopes to the public that their taxes will be lowered in the future, which I think is not going to be the case.

A permanent tax increase, especially one that raises increasing amounts of revenue each year, will put us firmly on the path toward a balanced budget, making it quite possible and credible that we could eliminate the deficit by about 1992 without voting for any additional taxes after this year. A temporary tax increase, on the other hand, will guarantee that we will be forced to revisit the tax issue just a couple of years from now or face many more years of unacceptably large deficits.

Second, although I am a strong advocate of increasing certain excise taxes, my first choice—and that of most of the people I represent back home—for raising additional revenues is to collect more income taxes from wealthy individuals. I say that as a member who represents the most affluent district in this country.

During Mr. Reagan's years as President, Congress has provided a truly astounding tax reduction for the wealthiest members of our society who are, of course, most able to pay a larger share of their income in taxes. In just 7 years, because of the Econonic Recovery Tax Act of 1981 and the tax reform bill of last year, the top rate on income will have dropped from 70 percent to 28 percent.

I realize that members of this committee are not excited about the prospect of revisiting the Tax Reform Act so soon after its passage, but the fact is that a great many Democrats on the floor voted for that measure with great reservation, feeling strongly that it had two major failings: it did not retain enough progressivity, and it used all the money from closing loopholes to give further tax cuts to people who had already received enormous benefits from the 1981 law.

Incidentally, as I said, it is not just Members of Congress who feel this way. It is the feeling of virtually everybody back home with whom you speak about the tax situation.

In addition, of course, many of us feel that by not using loophole closings to raise revenue we threw away the best and politically the most acceptable opportunity to raise revenues that we would have for many years to come.

Fortunately, it is not too late to change that law, both to improve progressivity and to raise revenues. I would urge this committee to recommend what our distinguished Speaker suggested earlier this year: Retain the 1987 individual tax rate of 38.5 percent for high-income earners. The Speaker, I believe, proposed keeping that higher rate for taxable income over $100,000 on single returns and $150,000 for joint returns. That would raise about $5.6 billion next year and substantially more in the years beyond; $11.8 billion in 1989, $14.5 billion by 1990—or we could just retain all of the 1987 individual income tax rates and raise even more revenue.

If we retained the 1987 rates, we would have a much more progressive structure which would also raise a large amount of additional revenue—about $9 billion next year, and much more in the following years; $18.8 billion by 1989, $23 billion by 1990—which I would point out to members of this committee is the entire amount called for that year by the reconciliation directives in the budget resolution which we have adopted.

All of the money for 1990 could be provided in that year simply by retaining the 1987 individual income tax rates. The great advantage, of course, of retaining the 1987 rates, either partially or wholly, is that it would not raise tax rates for anyone. It would simply deny further cuts in tax rates, but that will only be true this year. To gain revenue from income taxes in the future, we will have to raise tax rates which will be much more difficult politically than simply keeping rates at current levels.

Second to retaining 1987 tax rates, I would urge this committee to fulfill the remainder of its reconciliation directives with higher excise taxes for gasoline, cigarettes and alcohol.

I have long advocated increasing the Federal tax on gasoline because of the tremendous economic benefits which would result. I will not go into all of them at this time, but not only would a higher gasoline tax help reduce the Federal budget deficit by a huge amount—since each penny per gallon of tax yields about a billion dollars in revenues—it would also lessen our Nation's vulnerability to a new energy crisis and reduce the enormous U.S. trade deficit.

As you know, energy experts are predicting that by the early 1990s imports are likely to account for well over half of the oil we use—a much higher proportion than that which triggered our energy crises in the 1970s. Raising the gas tax is a way we can protect our Nation against an even more disastrous energy crisis in the 1990s.

By raising the price of gasoline through a higher tax, we would reestablish the incentives that Americans had just a few years ago to buy more fuel-efficient vehicles and cut back on nonessential driving.

In addition, because oil accounts for nearly one-quarter of the U.S. trade deficit, we could reduce that deficit, too, just by lowering our demand for this one commodity.

As unpopular as raising the gas tax is, we have to keep in mind that Americans are going to be paying more for gasoline whether we increase the tax on it or not. If we do nothing to curb our demand for imported oil, the cost of gasoline will go up anyway because oil supplies will decline and OPEC will again be able to raise its prices as it gains more control over the world oil markets. But if we raise the price of gasoline ourselves by imposing a higher tax, we will have lowered our demand for imported oil, kept OPEC from being able to raise its prices, and we will thus pay the entire extra cost of gasoline to ourselves instead of paying it to foreign oil producers.

I would also remind members of the committee that we now have a 9-cent-a-gallon Federal tax on gasoline. The States, obviously, have additional gasoline taxes. But no other Western industrialized nation has a tax of less than 80 cents per gallon, and some go as high as $1.60, $1.70. We are at 9 cents.

I also strongly support increasing the Federal excise tax on cigarettes. Earlier this year, I introduced a bill raising it to 40 cents a pack, and I am now working with several other members on a bill to try to double the tax to 32 cents a pack.

Doubling the cigarette tax would raise about $3 billion annually, but even if it barely raised any revenues at all, it would still be a good idea to raise the cigarette tax in order to discourage smoking, especially among young people, many of whom would be deterred from starting the habit if the price of cigarettes were increased.

As with the cigarette tax, because there are good public health reasons for raising taxes on beer and wine, I have introduced legislation tripling the taxes on beer and on the two types of wine which have the lowest concentration of alcohol and are most lightly taxed. That proposal would produce $2.5 billion annually.

I realize that many Members are concerned about the unpopularity of raising taxes on beer and wine, but it is important to keep in mind that these commodities are severely undertaxed by historic standards. The tax on beer and wine has not been raised since 1951. Inflation has increased by 400 percent since then, but we have charged the same amount as we did 36 years ago. At that time, the tax represented 5 percent of the purchase price; now it represents only seven-tenths of 1 percent.

Finally, I would like to briefly address the regressivity issue, which does concern me—as it does many of our colleagues—but which I do not think is a good argument against raising these particular taxes. Like many other members, I am concerned that our overall Federal tax system has become increasingly regressive in recent years. That is why I believe our first priority ought to be making the income tax structure more progressive than it will be if we allow the 1988 rates to effect.

But I would also like to point out that the increasing regressiveness of Federal taxation has not been due to excise tax increases, but to the restructuring of the income tax system and to steady increases in Social Security taxes, which are a far greater burden to moderate-income workers than are Federal excise taxes. In fact, excise taxes have declined as a share of Federal revenues from 18 percent in 1951 to only 4 percent last year.

Gasoline, cigarette, and alcohol taxes are really good taxes—the taxes themselves, apart from the revenue they produce, serve good public policy purposes. In all three cases, in my opinion, the drawback of their regressiveness is far outweighed by their social and economic benefits.

In summary—and I thank the members and also my colleagues here waiting even more for putting up with such a long statement—I would urge this committee to report a tax increase that is permanent, to recommend both income tax increases for high income individuals, and increased excise taxes on gasoline, cigarettes and some alcohol products.

I thank you again very much for giving me this opportunity to testify here today.

[The statement of Mr. Beilenson follows:]

STATEMENT OF CONGRESSMAN ANTHONY C. BEILENSON
BEFORE THE COMMITTEE ON WAYS AND MEANS
JULY 15, 1987

Mr. Chairman, thank you for providing me the opportunity to testify on ways to raise the additional revenues called for by the FY 1988 budget resolution.

As the author of bills to increase excise taxes on gasoline, cigarettes, and wine and beer, I greatly appreciate having the chance to talk about the merits of those proposals with the members of this committee. But before I do, I have two other suggestions about raising taxes.

First, regardless of the type of tax increases this committee recommends, I want to urge in the strongest terms possible that those increases be permanent. Although your reconciliation directive calls for raising specific amounts of revenues in 1988, 1989, and 1990, I would hope that your recommended provisions continue to raise revenue beyond those years. If, for example, you report any excise taxes, I would urge that they not expire after 1990, or if you decide to retain the 1987 individual tax rates, I would urge that you retain them permanently, not just for three years. I hope that you reject the idea of a "surtax," since that very name implies that it is temporary.

As you know, the need for additional revenues to bring the federal deficit under control is not going to suddenly disappear three years from now. If the taxes you recommend expire in 1990, then Congress is going to be faced again with voting for tax increases at that time. In addition, a temporary tax increase would also hold out false hopes to the public that their taxes will be lower in the future.

A permanent tax increase--especially one that raises increasing amounts of revenue each year--will put us firmly on the path toward a balanced budget, making it quite possible and credible that we could eliminate the deficit by about 1992 without voting for any additional taxes after this year. A temporary tax increase, on the other hand, will guarantee that we will be forced to revisit the tax issue just a couple of years from now, or face many more years of unacceptably large deficits.

Second, although I am a strong advocate of increasing certain excise taxes, my first choice for raising additional revenues is to collect more income taxes from wealthy individuals.

During Mr. Reagan's years as president, Congress has provided a truly astounding tax reduction for the wealthiest members of our society who are, of course, most able to pay a larger share of their income in taxes. In just seven years, because of the Economic Recovery Tax Act of 1981 and the Tax Reform Act of 1986, the top rate on income will have dropped from 70% to 28%.

I realize that members of this committee are not excited about the prospect of revising the Tax Reform Act so soon after its passage. But, the fact is, a great many Democrats voted for that measure with great reservation, feeling strongly that it had two great failings: it did not retain enough progressivity, and it used all the money from closing loopholes to give further tax cuts to people who had already received enormous benefits from the 1981 law. And, incidentally, it's not just members of Congress who feel this way; most everyone back home does, too.

In addition, many of us feel that by not using loophole closings to raise revenue, we threw away the best and, politically, most acceptable opportunity to raise revenues that we would have for many years to come.

Fortunately, it's not too late to change that law both to improve progressivity and to raise revenues. I would urge this committee to recommend what our distinguished Speaker suggested earlier this year: retain the 1987 individual tax rate of 38.5 percent for high-income earners. The Speaker, I believe, proposed keeping that higher rate for taxable income over $100,000 (single returns) and $150,000 (joint). That would raise about $5.6 billion in 1988 and substantially more in years beyond.

Or, we could just retain all the 1987 individual income tax rates, and raise even more revenue. If we retained the 1987 rates, we would have a much more progressive structure which would also raise a large amount of additional revenue--about $9 billion in 1988, and much more in following years.

The great advantage of retaining the 1987 rates, either partially or wholly, is that it would not raise tax rates for anyone; it would simply deny further cuts in tax rates. But that will only be true this year; to gain revenue from income taxes in the future, we will have to raise tax rates, which will be much more difficult, politically, than simply keeping rates at current levels.

Second to retaining 1987 tax rates, I would urge this committee to fulfill the remainder of its reconciliation directives with higher excise taxes for gasoline, cigarettes and alcohol.

I have long advocated increasing the federal tax on gasoline because of the tremendous economic benefits that would result. Not only would a higher gasoline tax help reduce the federal budget deficit--by a huge amount, since each penny per gallon of tax yields about $1 billion--it would also lessen our nation's vulnerability to a new energy crisis and reduce the enormous U.S. trade deficit.

As you know, energy experts are predicting that by the early 1990's, imports are likely to account for well over half of the oil we use--a higher proportion than that which triggered our energy crises in 1970's. Raising the gas tax is a way we can protect our nation against an even more disastrous energy crisis in the 1990's.

By raising the price of gasoline through a higher tax, we would reestablish the incentives American had just a few years ago to buy more fuel efficient vehicles and cut back on non-essential driving. By consuming less gasoline, we would lower our demand for imported oil. In fact, the bill I introduced to raise the gas tax by 25¢ a gallon would reduce oil imports by about 3.5 percent in the short run, and by about 11.4 percent in the long run. Even a lesser gas tax of 10¢ a gallon, for example, would would cut oil imports by about by about 1.4 percent in the short run, and about 4.6 percent in the long run.

In addition, because oil accounts for nearly one-quarter of the U.S. trade deficit, we would reduce that deficit, too, just by lowering our demand for this one commodity.

As unpopular as raising the gas tax is, Americans are going to be paying more for gas whether we increase the tax on it or not. If we do nothing to curb our demand for imported oil, the cost of gasoline will go up because oil supplies will decline, and OPEC will again be able to raise its prices as it gains more control over the world oil markets. But if we raise the price of gasoline ourselves, by imposing a higher tax, we will have lowered our demand for imported oil and kept OPEC from being able to raise its prices. We will thus pay the entire extra cost of gasoline to ourselves, instead of paying it to foreign oil producers.

I also strongly support increasing the federal excise tax on cigarettes. Earlier this year I introduced a bill raising it to 40¢ a pack, and I am now working with several other members who advocate doubling the cigarette tax, to 32¢ a pack.

Doubling the cigarette tax would raise about $3 billion annually. But even if it barely raised any revenues at all, it would still be a good idea to raise the cigarette tax in order to discourage smoking, especially among young people, many of whom would be deterred from starting the habit if the price of cigarettes increased.

As with the cigarette tax, because there are good public health reasons for raising taxes on beer and wine, I have introduced legislation tripling the taxes on beer and on the two types of wine which have the lowest concentration of alcohol and are most lightly taxed. This proposal would produce about $2.5 billion annually.

I realize many Members are concerned about the unpopularity of raising taxes on beer and wine, but it's important to keep in mind that those commodities are severely under-taxed by historic standards. The tax on beer and wine hasn't been raised since 1951. At that time, the tax represented 5 percent of the purchase price; now it represents only seven-tenths of one percent of it.

Finally, I would like to briefly address the regressivity issue, which does concern me, but which I don't think is a good argument against raising these particular taxes.

Like many other Members, I am concerned that our overall federal tax system has become increasingly regressive in recent years, and that is why I believe our first priority ought to be making the income tax structure more progressive than it will be if we allow the 1988 rates to take effect.

But I would also like to point out that the increasing regressiveness of federal taxation has not been due to excise tax increases, but to the restructuring of the income tax system and to steady increases in Social Security (FICA) taxes, which are a far greater burden to moderate income workers than are federal excise taxes. Excise taxes have declined as a share of federal revenues from 18 percent in 1951 to only 4 percent in 1986.

Gasoline, cigarette, and alcohol taxes are really good taxes--the taxes themselves, apart from the revenue they produce, serve good public policy purposes. In all three cases, the drawback of their regressiveness is far outweighed by their social and economic benefits. In fact, if we don't raise these taxes, then we are guaranteeing higher gasoline prices in the long run and more suffering from smoking- and alcohol-related health problems, which will be far more harmful to lower-income individuals than paying a little more now for gasoline, cigarettes, and beer and wine.

In summary, I urge this committee to report a tax increase that is permanent, and to recommend both income tax increases for high-income individuals and increased excise taxes on gasoline, cigarettes, and alcohol.

Thank you, again, for giving me this opportunity to appear before this committee today.

Mr. MOODY [presiding]. Thank you very much, Congressman Beilenson.

Congressman Glickman, I believe, is next.

Mr. BEILENSON. I have to leave.

Mr. MOODY. You have to leave?

Mr. BEILENSON. I am chairing the Committee of the Whole, Mr. Chairman.

Mr. MOODY. All right. Congressman Duncan, do you have any questions?

Mr. DUNCAN. I have one, if I might, Tony. You mentioned that doubling the tobacco tax would raise how much? $3 billion in new money?

Mr. BEILENSON. $3 billion a year.

Mr. DUNCAN. Are you familiar with the study that was requested by Senator Mitchell from the CBO, which states an increase in the excise tax on tobacco would be the most regressive of all tax measures considered? The percent of income of tobacco excise taxes is 27 times higher for low-income families. Are you familiar with that study?

Mr. BEILENSON. Yes, sir, I am.

Mr. DUNCAN. Now, if it is regressive, how could you get more taxes?

Mr. BEILENSON. Because I am for certain taxes that are partially regressive, and this is one of them. I think we undertax our cigarettes. I think you can demonstrate very easily the cost to nonsmokers is so very great, and the billions of dollars we spend for health care costs each year on behalf of these people would——

Mr. DUNCAN. The context of regressive means that you are going to get less taxes than we are today.

Mr. BEILENSON. That may well be true, Mr. Duncan. The figures I have seen is that it hovers around $3.0, $3.1, $2.9, $2.8 billion. Frankly, I would not mind getting a little less revenue if, in fact, this discouraged people, especially younger people with less discretionary income, from picking up the habit in the first place.

Mr. DUNCAN. We have jurisdiction on taxes, but not on health.

Mr. BEILENSON. I understand. It does not hurt to keep health in mind.

Mr. DUNCAN. Thank you very much.

Mr. BEILENSON. You are very welcome, sir.

Mr. MOODY. Let me just ask you this. Obviously, it is regressive relative to income, clearly. But is it not at the low income people where you, in effect, want it to be regressive to discourage them from smoking? The higher the income of the person, the less the discouragement factor. In fact, who are low income people? Other things equal, they tend to be young people. They have less discretionary income, 14-, 15-year-olds who are beginning their smoking.

Mr. BEILENSON. And especially young women who are taking it up in much greater numbers, even as adults slowly break the habit.

Mr. MOODY. My point is the regressivity, in fact, is a plus.

Mr. BEILENSON. I agree.

Mr. MOODY. If you are trying to discourage the usage of the commodity.

Mr. BEILENSON. I agree with the chairman. In this particular case, I do not mind using a tax as a discouragement.

Mr. DUNCAN. If you will yield?

Mr. MOODY. I yield to the gentleman.

Mr. DUNCAN. It certainly is not a plus when you take away the right of a low income person and say, well, the wealthy can smoke all they want because they can afford it. I cannot see that.

Mr. BEILENSON. Well, Mr. Duncan, that is——

Mr. DUNCAN. I do not think that is the intent of our country, and I do not think that is the intent of this committee to classify people. You can do it if you wish, but I am not going to be a part of it. In effect saying to the wealthy you can smoke because you can afford it. I have feeling for those low-income people.

Mr. BEILENSON. I do, too, although I must admit I do not represent an awful lot of them. And I do not think we would take away their right to smoke. They would have to pay 16 cents a pack more to do so, but it is also true, Mr. Duncan, that we as taxpayers pay a great deal more for the health care costs of low-income people who die by the tens of thousands, 300,000 a year, because of smoking than we pay for the health care costs of the wealthy. So I think you could argue that, too.

Mr. DUNCAN. Well, it has been shown—in fact, it is in the Congressional Record put in by one of the Iowa Members last year—that there is a high cancer rate among people who work in the wheat industry. Should we perhaps put a tax on every bushel of wheat or something?

Mr. BEILENSON. I have a friend sitting next to me who——

Mr. DUNCAN. And other products that have a cancer rate related to their workplace.

Mr. BEILENSON. I understand the gentleman's arguments, and if I were the gentleman, I would make them, too. As I said at the outset, the principal concerns of this Member is that we do raise the amounts of money asked for in the budget resolution, and that our principal way of doing it is to ensure that any taxes we raise are permanent because we are going to need them in the future; and second, that we go after high income people who have been given two huge breaks in recent years. Thereafter, you may have to fill in with revenues from higher excise taxes.

I personally would like to see a higher cigarette tax, and interestingly enough, if I may say so to my friend from Tennessee, the people of this country in poll after poll overwhelmingly by 80 to 85 percent favor higher cigarette taxes, and that includes a substantial proportion of smokers themselves who know they are doing something which is not good for them and would not feel all that bad, perhaps would have some of their guilt assuaged if they paid a little more for it.

Mr. DUNCAN. Lastly, I do not consume or produce tobacco products, but I think you have got to be fair. I think you are being totally unfair when you talk about this and not other products.

Mr. BEILENSON. May I say in my final remark to my friend that I may be being unfair to those folks, but I am being even more unfair to the drivers of southern California, whom I do represent—unlike the tobacco-producing people—when I ask for a large increase in the gas tax.

Mr. **Duncan**. Thank you so much.

Mr. **Beilenson**. So I am at least being consistently unfair.

Mr. **Kasich**. Mr. Chairman, I just want to say that I will bet how I can guess how both of these guys voted on the Durbin amendment the other night.

Mr. **Duncan**. That is right.

Mr. **Moody**. Does the gentleman from Michigan wish to inquire?

Mr. **Levin**. Just as Mr. Beilenson leaves, your eloquence is much appreciated.

Mr. **Beilenson**. Thank you, Mr. Levin.

Mr. **Levin**. Maybe because I agree with you on the latter subject.

Mr. **Beilenson**. I do thank you all very much for letting me speak first. I am supposed to be doing something else, but I would rather be here, frankly.

Mr. **Moody**. Thank you. The gentleman from Kansas is recognized.

STATEMENT OF HON. DAN GLICKMAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF KANSAS

Mr. **Glickman**. Thank you. In an eclectic vein, I am going to switch subjects on you and talk a little bit about airplanes, because I come from Wichita, Kans., where we make half the airplanes in the world.

I am here to talk to you about two revenue options which I noted in the Joint Committee on Taxation publication on revenue-raising options which talk about raising the excise taxes on ticket and fuel taxes and the option of imposing a luxury excise tax on noncommercial aircraft.

First of all, I did vote for the budget resolution. I do think that raising revenues have to be part of the procedures, and I agree with much of what my colleague from California said. But I do have to talk about a parochial interest, also one that I think affects America in general.

Relative to the proposal to continue the current excise taxes on aviation fuel and to increase the airline ticket tax from 8 to 10 percent, I want to remind my colleagues that the airport trust fund has $9 billion in it right now reserved for airport and aircraft safety and airport improvements. There is plenty of work to be done in that regard, as is evidenced by the growing air safety problems travelers in this country are facing. But the fact remains that these funds are not going to meet the needs for which they are collected.

It is clear the administration has decided to make this trust fund a convenient place not to spend money to help make the deficit look better. In my view, that amounts to collecting those taxes under false pretenses as it already stands. It would be most disingenuous to add to that in the name of deficit reduction. We have $9 billion in the trust fund; to raise the excise tax another 2 percent would be ridiculous because the money that is being collected is not being spent on safety.

I came to the floor two nights ago and offered an amendment to spend a little more money out of the trust fund for air safety. I was ruled out of order on a point of order. But why raise the excise tax when, in fact, we are not spending the money? It is collecting in the trust fund.

With regard to the proposal to impose a luxury excise tax on noncommercial airplanes—that is everywhere from a Cessna 172, the type that landed in Red Square and made in my home town, to a Lear jet or a Citation 3—I feel a little deja vu. The idea has been up before and, fortunately, it has been rejected. To put it simply, I am very firmly of the belief that these aircraft are not luxury items for a number of reasons.

Virtually all of these aircraft are business tools which, before the repeal of the investment tax credit effective this past January, qualified for the ITC. The fact of the matter is that these aircraft qualified for the ITC were business tools and continue to be business tools.

I would also stress that these aircraft are vitally important to the economic viability of rural areas in this country, particularly those that are not served by commercial air service. Without the ability to have access to rural areas, and even to smaller urban areas, which particularly since airline deregulation in 1978 have very limited air service, it would only be logical to assume that firms would move their operations away from areas that are difficult to go to.

With the extremely weak agricultural economy at this time, I would hope that this committee would not want to take any action which would have the effect of further undermining the rural areas which are so tied to agriculture.

Finally, I want to let the committee know about the serious state of general aviation. Listen to this number. In 1980, 17,000 airplanes were manufactured. In 1986, 1,000 were manufactured. Imagine that. From 17,000 general aviation airplanes in 1980 to 1,000 general aviation airplanes in 1986. I can tell you what has happened to the work force in the production of airplanes, not just in Beech and Cessna and Lear and Wichita, but Piper and all of the other companies in this country that are making small airplanes.

You talk about a depression in an industry. This makes the problems, proportionately, in the steel industry and the oil industry and a lot of others look like pikers compared to what we have faced in the building of small airplanes.

Mr. MOODY. Did you say "Pipers" or "pikers"?

Mr. GLICKMAN. Pikers. But I suppose you could use either term. In any event, you have got two proposed revenue options: One is to raise excise taxes on aviation fuel and increase airline ticket taxes from 8 to 10 percent; the other is to classify small airplanes as a luxury and tax them on that basis. I submit to you, my colleagues, that if you do that you will absolutely kill, you will hit the nail in the coffin of the general aviation industry. I would urge you to reject that not only for the workers who produce the planes, but for small-town America all over this country that depends on small airplanes to basically survive.

I thank you for allowing me to testify today.

[The statement of Mr. Glickman follows:]

STATEMENT BY
REPRESENTATIVE DAN GLICKMAN (D-KS.)
BEFORE HOUSE WAYS AND MEANS COMMITTEE
WEDNESDAY, JULY 15, 1987

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE. I appreciate the opportunity to be here today, but I regret having to come. I am here to urge you not to move forward two particular revenue options which I noted in the Joint Committee on Taxation publication on revenue raising options. Those two are the option of raising Airport and Airways Trust Fund excise taxes and the option of imposing a luxury excise tax on non-commercial aircraft. Before I begin, let me make two points just for the record. First, I did vote for the budget resolution and have held the view that the revenue side of the picture should be part of the budget negotiations. Second, I represent Wichita, Kansas, where general aviation manufacturing is an important part of the economy.

Relative to the proposal to continue current excise taxes on aviation fuel and to increase the airline ticket tax from eight to ten percent, I would only remind my colleagues on this committee that the Airport and Airways Trust Fund already has a surplus in the range of $9 billion which is statutorily reserved for airport and airways improvements. There is plenty of work to be done in that regard, as is evidenced by the growing air safety problems travellers in this country are facing, but the fact remains that those funds are not going to meet the needs that they are collected to meet. It is clear to me that Administration officials have already decided that this trust fund is a convenient place not to spend money to help make the deficit look better. In my view, that amounts to collecting those taxes under false pretenses as it already stands. It would be most disingenuous to add to that in the name of deficit reduction.

With regard to the proposal to impose a luxury excise tax on non-commercial aircraft, I feel a little deja vu. This idea has come up before, and, fortunately, it has been rejected. To put it simply, I am very firmly of the belief that these aircraft are NOT LUXURY ITEMS for a number of reasons.

Virtually all of these aircraft are business tools, which before the repeal of the investment tax credit (ITC) effective this past January qualified for the ITC. Those of you on this committee know that business use was a criteria which had to be met before the ITC was allowed. Now to make the leap from that well-founded reasoning to a determination that these are luxury items would be almost impossible to understand, let alone explain. The fact of the matter is that these aircraft are business tools which are prudently used in a very circumscribed fashion.

I would also stress that these aircraft are vitally important to the economic viability of non-urban areas which are either not served or poorly served by commercial air service. Without the ability to have access to rural areas and even to smaller urban areas which -- particularly since airline deregulation in 1978 -- have very limited air service, it would be only logical to assume that firms would move their operations away from areas that are difficult to get to. With the extremely weak agricultural economy at this time, I would hope that this committee would not want to take any action which would have the effect of further undermining the rural areas which are so tied to agriculture.

Finally, the general aviation industry which manufactures these aircraft is suffering already. It does not need the added problems of imposition of further taxes. I would ask my colleagues to look at this from the perspective of a worker in the general aviation industry who is out of a job; to that person, I am sure these aircraft are not a luxury. And there are all too many workers who once had jobs in general aviation manufacturing who do not have those jobs today. In fact, industry sales which were over 17,000 aircraft back in 1980 are under 1,000 aircraft this year. That translates into a workforce which, as of statistics compiled last summer, is down some sixty-six percent from its 1980 level.

My friends, I hope my message is clear. These options would add burden to a suffering industry and would inevitably cost jobs at a time when we should be working to strengthen this industry which just a few years ago was a leader in U. S. manufactured exports. In the strongest possible terms, I call on this Committee to reject these options before they worsen an already difficult situation.

Mr. MOODY. Thank you very much for a good statement.

The gentleman from Tennessee.

Mr. DUNCAN. I have no questions other than to thank you very much.

Mr. MOODY. All right.

Mr. GLICKMAN. Thank you very much.

Mr. MOODY. Thank you.

Next on the list, we are just going right down the order here, is Nick Joe Rahall, Member from West Virginia.

STATEMENT OF HON. NICK JOE RAHALL II, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF WEST VIRGINIA

Mr. RAHALL. Thank you, Mr. Chairman, Mr. Duncan, members of the committee.

Among one of the possible options being examined to comply with the fiscal year 1988 budget resolution are two proposals affecting the Federal black lung program. They are to raise the coal excise tax by 65 percent and to include black lung benefits as taxable income.

As you may recall, Mr. Duncan, and certainly Chairman Rostenkowski, for fiscal year 1985 the administration did propose a 50-percent increase in the coal excise tax to address what it believed was the underfunding of the Black Lung Disability Trust Fund. To this committee's great credit, to the ranking minority member, Mr. Duncan, to Chairman Rostenkowski's credit, the conference on the fiscal year 1985 budget reconciliation bill agreed instead to a 10-percent increase reflecting the compromise approach which we all worked out that would bring the black lung trust fund into solvency by the year 2014.

I want to take a special moment to commend the ranking minority member and Chairman Rostenkowski for their most admirable work in sticking to this compromise approach and to their commitments on this compromise. The chairman diligently consulted with myself and other Members from coal States when pressure mounted, the heaviest upon him, to backslide from this compromise approach. I appreciate that, as well as other Members from coal-producing and/or consuming districts across this Nation.

The approach that was adopted by this committee last year brought a measure of security to the trust fund. It not only did that, but it did so in a fashion which does not jeopardize future coal production and coal mine employment, both of which are important for the national security of this nation and for our future economic well-being. An additional tax increase is not needed and, in fact, would be a serious breach of faith with the various parties who just last year agreed to this compromise funding mechanism and agreed to by the administration.

It should also be noted that a further increase in the black lung excise tax would have the opposite effect of that intended by the administration. Such an increase would put many marginally profitable coal producers out of business, and to use that wornout phrase that my colleague from Kansas just used, it no doubt would put the nail in the coffin for many small, independent coal producers who are the backbone of our energy producing resources in this country. This would lead to less coal production and consequently a decline in tonnage that is subject to the excise tax. The result: A greater deficit in the black lung trust fund and greater unemployment in the heartlands of America.

The second proposal, also advanced by the administration, is so mean spirited that it defies comprehension and imagination. Black lung victims and their survivors are not, as I no doubt do not need to tell the committee, among the richest of Americans. A disabled miner or his or her survivor with no dependents receives less than $5,000 per year in black lung benefits, while a miner or survivor with three or more dependents receives approximately $8,000 per year. Since the black lung program began, the IRS has treated these benefits as modest subsistence payments and not as net income replacement.

Last year, the committee authorized the most far-reaching tax reform bill in recent history. One of our greatest achievements was to remove over 6 million poor people per year from the tax rolls. Taxing black lung benefits at this time would not keep faith to the commitment we made to the Nation's low and no-income population only last year.

One other part of that compromise package agreed to by this committee in last year's bill was with regard to the coal depletion allowance. While the administration had proposed a total elimination of that allowance in last year's tax proposal, this committee—much to its credit and good commitments made to those of us from coal-producing States—agreed to only half a loaf that the coal industry today is living with. I submit that to totally eliminate that depletion—that is, zero it out—would not be in good faith with the coal industry in this country.

Mr. Chairman, that concludes my testimony. I appreciate again the opportunity to appear before you. I want to express not only my deep appreciation, but that of the active and retired American coal miner for your assistance in matters relating to the black lung trust fund program.

Mr. MOODY. Thank you for a very strong statement.

The gentleman from Tennessee.

Mr. DUNCAN. I want to thank you, Nick, for an excellent statement. I do not know of anyone who is more authoritative on the problems of the coal miner and the coal mining industry than you are. I am just sorry we did not have more people to hear your statement. I hope they will read it later.

Thank you.

Mr. MOODY. Every statement of the members here will be, of course, in the record permanently.

Thank you very much, Mr. Rahall.

Next on our list is the Honorable Gerald B.H. Solomon, a Member of Congress from New York. Welcome to the committee.

STATEMENT OF HON. GERALD B.H. SOLOMON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK, AND RANKING MINORITY MEMBER, SUBCOMMITTEE ON HUMAN RIGHTS AND INTERNATIONAL ORGANIZATIONS, COMMITTEE ON FOREIGN AFFAIRS

Mr. SOLOMON. Thank you very much, Mr. Acting Chairman, and my two good friends who are willing to sit here and listen to each of us go over our individual interests. Might I just say I appreciate this opportunity to appear before the committee in order to express my concern over one of the options for increased revenue. Specifically, I am referring to the proposed excise tax on ozone-depleting chemicals.

Mr. Chairman, I speak as a member of the Committee on Foreign Affairs which, together with the Committee on Energy and Commerce, shares oversight responsibilities on our Government's efforts to negotiate an international agreement for the protection of the ozone layer. I serve as the ranking Republican on the Foreign Affairs Subcommittee that has the most immediate jurisdiction on this issue.

Mr. Chairman and my colleague from Tennessee, I would at this time like to insert a letter in the record from the chairman of the Foreign Affairs Committee, Mr. Dante Fascell, and from the chairman of the Subcommittee on International Organizations and Human Rights, Mr. Gus Yatron, who are in support of my position on this excise tax.

Mr. MOODY. Without objection, it will be put in the record.

[The following was subsequently received:]

DANTE B. FASCELL, FLORIDA, CHAIRMAN

LEE H. HAMILTON, INDIANA
GUS YATRON, PENNSYLVANIA
STEPHEN J. SOLARZ, NEW YORK
DON BONKER, WASHINGTON
GERRY E. STUDDS, MASSACHUSETTS
DAN MICA, FLORIDA
HOWARD WOLPE, MICHIGAN
GEO. W. CROCKETT, JR., MICHIGAN
SAM GEJDENSON, CONNECTICUT
MERVYN M. DYMALLY, CALIFORNIA
TOM LANTOS, CALIFORNIA
PETER H. KOSTMAYER, PENNSYLVANIA
ROBERT G. TORRICELLI, NEW JERSEY
LAWRENCE J. SMITH, FLORIDA
HOWARD L. BERMAN, CALIFORNIA
MEL LEVINE, CALIFORNIA
EDWARD F. FEIGHAN, OHIO
TED WEISS, NEW YORK
GARY L. ACKERMAN, NEW YORK
MORRIS K. UDALL, ARIZONA
CHESTER G. ATKINS, MASSACHUSETTS
JAMES McCLURE CLARKE, NORTH CAROLINA
JAIME B. FUSTER, PUERTO RICO
JAMES H. BILBRAY, NEVADA
WAYNE OWENS, UTAH
FOFO I.F. SUNIA, AMERICAN SAMOA

JOHN J. BRADY, JR.
CHIEF OF STAFF

One Hundredth Congress
Congress of the United States
Committee on Foreign Affairs
House of Representatives
Washington, DC 20515

WILLIAM S. BROOMFIELD, MICHIGAN
BENJAMIN A. GILMAN, NEW YORK
ROBERT J. LAGOMARSINO, CALIFORNIA
JIM LEACH, IOWA
TOBY ROTH, WISCONSIN
OLYMPIA J. SNOWE, MAINE
HENRY J. HYDE, ILLINOIS
GERALD B.H. SOLOMON, NEW YORK
DOUG BEREUTER, NEBRASKA
ROBERT K. DORNAN, CALIFORNIA
CHRISTOPHER H. SMITH, NEW JERSEY
CONNIE MACK, FLORIDA
MICHAEL DeWINE, OHIO
DAN BURTON, INDIANA
JAN MEYERS, KANSAS
JOHN MILLER, WASHINGTON
DONALD E. "BUZ" LUKENS, OHIO
BEN BLAZ, GUAM

STEVEN K. BERRY
MINORITY CHIEF OF STAFF

July 15, 1987

The Honorable Dan Rostenkowski
Chairman
Committee on Ways and Means
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr Chairman:

We are writing to you regarding a proposal before your Committee to impose an excise tax on ozone-depleting chemicals.

We are strong supporters of efforts to eliminate as rapidly as possible the serious threat which ozone depletion presents to the world community. We believe that the most effective way to achieve this objective is through international agreement. Currently substantive international negotiations are now being held to reach agreement on an international regime to control production of the chemicals which threaten the ozone layer.

While an excise tax on chemicals which damage the ozone layer may at some point be a useful complement to a global scheme of chemical controls we believe the imposition of such a tax at this time would be premature. Imposition of a tax now might unintentionally undermine our efforts to secure as comprehensive international agreement as possible. We therefore urge the Committee on Ways and Means to defer imposition of any additional tax on ozone-depleting chemicals until an international agreement has been concluded and your Committee has an opportunity to review how such a tax would affect an agreement.

With best wishes, we are

Sincerely,

Gus Yatron
Gus Yatron
Chairman
Subcommittee on Human Rights
& International Organizations

Dante B. Fascell
Dante B. Fascell
Chairman
Committee on
Foreign Affairs

DBF/GY:RMFdmh

Mr. SOLOMON. Mr. Chairman, it is my belief that imposition of this proposed tax is both ill advised and most certainly it is ill-timed. It would represent one more unilateral step by the United States when our companies are already at a competitive disadvantage. Moreover, it would come at a crucial time in which sensitive international negotiations on this very, very important subject are on the verge of bearing fruit after so many long years.

When I say that this proposed tax is ill advised, I have in mind the fact that business and Government and environmental groups have worked long and hard on this issue of ozone depletion in a manner that is relatively harmonious, particularly in comparison with other environmental protection issues in which these three groups are often at loggerheads. On this issue, they are not. There is general agreement that certain chemicals, particularly the chlorofluorocarbon—so-called CFCs—have a detrimental effect on the ozone layer in the atmosphere that protects the earth from harmful solar radiation.

Mr. Chairman, since 1974, the United States has unilaterally reduced the manufacture of CFCs by 50 percent nationwide. The most well-known such reduction was the ban imposed in 1978 on the use of aerosol propellants, if you all recall that. Unfortunately, only a handful of other countries followed our lead at that time, and none of our major trade competitors, particularly Japan and Western Europe, were among those. As a matter of fact, worldwide production of CFCs has increased at the same time that our own industry in this country has declined. Today, our country accounts for only about 25 percent of the overall production of this particular chemical.

The United States annually exports more than $20 billion worth of products that use this chemical, and to place further handicaps on the entry of these products into the global marketplace simply does not make any sense as of right now. We learned the hard way with our decision on aerosol propellants that foreign competitors will fill a space the United States decides to vacate. Therefore, we gain nothing.

When I say that this proposed tax is ill timed, Mr. Chairman, I have in mind the fact that our own Government's diligent efforts to establish an international regime regulating the production and use of CFCs and other ozone-depleting chemicals are nearing fulfillment. This is very, very important. Recognizing that the problem of ozone-depletion is global in scope, and that the problem has actually gotten worse since the United States began unilateral steps more than a decade ago, our Government has been in the forefront of negotiations that have been undertaken under the auspices of the UN environmental program.

In March of 1985, work was completed on the Vienna Convention for the Protection of the Ozone Layer. The United States signed that convention, and our signature was ratified by the U.S. Senate just last year. For the past 2 years, we have been actively engaged in the preparation of an international protocol that will implement the terms of the convention. Final agreement on the protocol is expected in September of this year, and it will then be submitted to the Senate for ratification.

Further action by our Government will be announced on Decem ber 1 when the Environmental Protection Agency, pursuant to an agreement worked out with the National Resources Defense Council and private industry together, will reveal specific plans and timetables on how the United States expects to comply with the international regime on CFCs and ozone-depleting chemicals that should then be in place.

Last, Mr. Chairman, let me just say that I mentioned the figure of $20 billion in exports. If we make the industry any less competitive than it is already, we are jeopardizing that $20 billion export business. That affects the Carrier Corporation in New York, with thousands of employees; it affects workers all over this country, in Illinois and Pennsylvania and many, many other areas. It means not only the loss of that export business, but it also means a loss of jobs and a loss of income tax from those jobs of people no longer working. It means a loss of corporate tax revenues, and it means an increase in unemployment and welfare benefits. We all know that when unemployment goes up just a mere one percent in this country, in triggers in $30 billion—not million—$30 billion in new spending programs in the Federal Government.

When you figure in the loss of jobs, the loss of income taxes, the loss of revenues coming in, that, in my opinion, would more than offset any small excise tax revenue that would be raised. And, as my good friend Nick Rahall said, in making his point, it would be the nail in the coffin for many of these areas of the country. This will be continued on down the line here, I am sure, today, but I just want to say this: we all seek to protect the environment, we know the dangers that lie here, but if we unilaterally take this step and knock our businesses out, that means there is no incentive for Japan—and we all know how they react sometimes—there is no incentive for them to follow through.

So let us stay on a competitive, even level with them, and let us not enact this excise tax yet. Maybe next year might be another story.

Thank you, Mr. Chairman.

Mr. Moody. Thank you. Did you say that a 1-percent increase in unemployment costs us $30 billion on the spend-out side?

Mr. Solomon. That is right. In other words, when the unemployment increases or decreases, either way, then Federal spending through unemployment benefits, through welfare programs, food stamps, et cetera, shifts by $30 billion per percentage point. So I think not only in this excise tax consideration, but in opposing what Tony Beilenson had to say, he is in favor of all taxes, we have to be very careful on any tax we enact because if it creates unemployment, then we lose what we gain.

Mr. Moody. You would agree, though, that failure to reduce the deficit may well push interest rates higher than they would be, which is another form of tax that also creates unemployment?

Mr. Solomon. I sure do, but let me tell you just very briefly a quick story, Mr. Chairman, because it will give you my philosophy on all of these tax ideas before the committee today.

Back in 1980, Governor Reagan and I were traveling from Iowa to New Hampshire. He had just lost the caucus there, and I was pretty dejected. He came over to me and he said, "Jerry," he said, "don't worry. We are going to New Hampshire; we are going to win that primary and go on to become President of the United States."

I said to him then, "You know, Ronald Reagan, I would follow you to the end of the earth." Well, you know, he has a long memory. Two years later in 1982, after we had enacted the 1981 Tax Reduction Act and all of that, the people in this Congress, some of them, had convinced the President he ought to go along with supporting a tax increase of $20 billion, called the National Tax Equity Act. I was not going along with him.

So he took me up to Camp David, took me out in back of the woodshed and sat me on a brick fence back there, and he said, "Jerry, do you remember on that plane to New Hampshire you told me you would follow me to the end of the earth? I need your vote on this tax increase." I said, "Mr. President, I remember saying that to you, and as far as I am concerned, this is the end of the earth. I ain't voting for that tax package."

As you know, we did not cut taxes. We raised $20 billion in taxes. We did not reduce spending a nickel, and I am afraid that is what might happen. So we have got to be very careful, Mr. Chairman.

Mr. MOODY. It turns out the President has a pretty good memory after all.

Mr. SOLOMON. That is right. He sure does. He is like an old uncle of mine. He remembers what he wants to remember.

Mr. MOODY. Thank you.

The gentleman from Tennessee, any questions?

Mr. DUNCAN. I have no questions, Mr. Chairman. I do want to thank our able colleague on a very informative subject. Thank you.

[The prepared statement follows:]

STATEMENT BY

REPRESENTATIVE GERALD B. SOLOMON

TO

THE COMMITTEE ON WAYS AND MEANS

JULY 15, 1987

Mr. Chairman and Members of the Committee,

I appreciate this opportunity to appear before the Committee in order to express my concern over one of the options for increased revenue that was contained in the report issued by the Joint Committee on Taxation on June 25. Specifically, I am referring to the proposed excise tax on ozone-depleting chemicals. As you know, legislation that would impose this tax was introduced by Representative Stark on June 30.

I speak as a member of the Committee on Foreign Affairs which, together with the Committee on Energy and Commerce, shares oversight responsibilities on our government's efforts to negotiate an international agreement for the protection of the ozone layer. I serve as the ranking Republican on the Foreign Affairs subcommittee that has the most immediate jurisdiction on this issue.

It is my belief that imposition of this proposed tax is both ill-advised and ill-timed. It would represent one more unilateral step by the United States when our companies are already at a competitive disadvantage. Moreover, it would come at a crucial time in which sensitive international negotiations on this very subject are on the verge of bearing fruit.

When I say that this tax proposal is ill-advised I have in mind the fact that business, government, and environmental groups have worked on the issue of ozone-depletion in a manner that is relatively harmonious, particularly in comparison with other environmental protection issues in which these three groups are often at loggerheads. There is general agreement that certain chemicals, particularly chloroflourocarbons (so-called CFCs), have a detrimental effect on the ozone layer in the atmosphere that protects the earth from harmful solar radiation.

Since 1974, the U.S. has unilaterally reduced the manufacture of CFCs by 50%. The most well-known such reduction was the ban imposed in 1978 on the use of CFCs in aerosol propellants. Unfortunately, only a handful of other countries followed our lead --- and none of our major trade competitors, Japan and Western Europe, were among them. Worldwide production of CFCs has increased at the same time ours has declined, and today our country accounts for only about 25% of the overall production of this chemical.

The U.S. annually exports more than $20 billion worth of products that use CFCs. To place further handicaps on the entry of these products into the global marketplace simply does not make sense. We learned the hard way with our decision on aerosol propellants that foreign competitors will fill a space the U.S. decides to vacate.

When I say that this proposed tax is ill-timed I have in mind the fact that our government's diligent efforts to establish an international regime regulating the production and use of CFCs and other ozone-depleting chemicals are nearing fulfillment. Recognizing that the problem of ozone-depletion is global in scope, and that the problem has actually gotten worse since the U.S. began taking unilateral steps more than a decade ago, our government has been in the forefront of negotiations that have been undertaken under the auspices of the UN Environmental Program.

In March 1985, work was completed on the Vienna Convention for the Protection of the Ozone Layer. The U.S. signed that convention, and our signature was ratified by the Senate last year. For the past two years, we have been actively engaged in the preparation of an international Protocol that will implement the terms of the Convention. Final agreement on the Protocol is expected in September, and it will then be submitted to the Senate for ratification.

Further action by our government will be announced on December 1 when the Environmental Protection Agency, pursuant to an agreement worked out with the National Resources Defense Council and private industry, will reveal specific plans and timetables on how the U.S. expects to comply with the international regime on CFCs and ozone-depleting chemicals that should then be in place.

Speaking as one who has followed this issue for many years from the vantage point of the Committee on Foreign Affairs, I have to ask if now is the time to take a step such as the one contemplated by this Committee as it considers the proposed excise tax. I am convinced that such a tax at this time can only have the effect of intruding on years of effort that are finally bearing fruit.

Mr. Chairman and Members of the Committee, we all seek to protect the environment. And we all seek a fair deal on international trade. But the history of this particular issue clearly demonstrates the folly of unilateral approaches in pursuit of these goals. Now that our multilateral efforts are on the brink of success, let's not jeopardize the progress that has been made.

Mr. MOODY. OK. My impression is that Congresswoman Schneider has been waiting the next longest after those who have spoken already. Is that correct? That is my impression. All right, Congresswoman Schneider.

The gentlelady from the Rhode Island is recognized. Welcome to the committee.

STATEMENT OF HON. CLAUDINE SCHNEIDER, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF RHODE ISLAND

Ms. SCHNEIDER. Thank you. I am delighted to be here with you, Mr. Chairman, considering that I am here to voice my opposition to at least one of the revenue options the committee is considering, if not all of them. This is the so-called luxury tax. I am here in particular to point out the potentially adverse affects such a tax would have on the Nation's jewelry industry. Now, I do so not as one who has been known on occasion to delight in the purchase of the fruits of this industry, but as the representative of the tens of thousands of Rhode Island families who rely on the manufacture of costume jewelry for their livelihood.

I would also like to speak to all of you today beyond parochialism in the name of a statesman-like approach in that I believe that every effort has not as yet been exhausted in reducing spending.

Mr. Chairman, I represent a State where jewelry manufacturing is the second largest employer. Rhode Island is the Nation's capital for costume jewelry manufacturing. If the jewelry tax were levied, the citizens of Rhode Island would be very sorely affected. This 10 percent tax would, without a doubt, put undue strain on an industry that is already facing intense overseas competition.

Still, what I find very rewarding is that the jewelry industry—unlike many other industries today—has not come to the Federal Government in asking for assistance in the offshore threat. Not long ago, as a matter of fact, I toured several Rhode Island jewelry manufacturers, and I saw firsthand just how they were reacting to the mounting foreign competition. I witnessed an increased emphasis on streamlining operations, increasing productivity and efficiency, seeking out specialty markets, improving marketing techniques, and emphasizing quality in the manufacture of their product. I cannot help but wonder, Mr. Chairman, what kind of debilitating effect an added tax would have on this particular industry.

It is very easy for me to see the political advantage of proposing a luxury tax because it appears to be a tax that would fall on the richest of the rich. But in reality, it would fall on the purchaser of class rings, charm bracelets, wedding bands, birthday presents, lapel pins and earrings. If the committee decides to pursue this revenue option, what is needed, I believe, is a modified definition of the term "luxury." Figures provided to me show that more than half of the karat gold jewelry is purchased by households with incomes of $30,000 or less. The very wealthy, whose luxury purchases can occur without the same consideration to cost as the average taxpayer, would neither feel the bite nor fill the tax coffers if a luxury tax were imposed.

That is my second—what I consider to be rather critical—point; that when the excise tax on jewelry was repealed in 1965, it was this very committee that pointed out that luxury taxes raised only a very small amount of revenue. Today, with estimates of potential revenues between 1 and 5 percent of the total required, that still remains the case.

In addition to that, in the past the committee has also noted the huge administrative burden that the luxury tax was causing, which in effect further diminished the net revenue of the tax. That point is also equally valid today. So not only will the Internal Revenue Service incur huge administrative costs, but each jewelry manufacturer will also add to its administrative costs, thus further hampering their competitive viability. Considering the additional pressures generated from us as we enter the global marketplace, it is clear that such a tax would be devastating to the U.S. jewelry industry.

Mr. Chairman, if the committee must, in fact, raise revenue, I urge it to consider approaches that are not regressive, that are easily administered, and that will accomplish the revenue targets needed. I am confident that when all the evidence is in you will agree with me that an excise tax on jewelry is not the way to go.

Thank you.

Mr. ANDREWS [presiding]. Any questions, Mr. Duncan?

Mr. DUNCAN. I have no questions other than to thank you very much for being here.

Mr. ANDREWS. Thank you for your testimony.

Mr. McCurdy.

STATEMENT OF HON. DAVE McCURDY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OKLAHOMA

Mr. McCURDY. Thank you, Mr. Chairman. It is a pleasure to appear before you today and certainly to follow my colleague from Rhode Island who is a very able representative of the interest of her State.

I am pleased to come before the committee today to express my support for an oil import fee as a means of raising revenue to meet the requirements of the budget reconciliation process. There are many good arguments for imposing such a fee, and I will discuss several of them. But there is none more important than our need to be able to defend our Nation, not just in the 21st century, but this day and tomorrow and next year. We cannot meet a national emergency if we do not have an oil industry that can supply our needs. When our refineries are shut down, they cannot begin operations again next week. But oil imports can be cut off next week. If we cap stripper wells in Oklahoma, that oil is lost. The crude dissipates when the well is capped, and we cannot retrieve it.

People may suggest that the smart thing to do is to use other countries' oils or resources so that ours will be here when we need it. That might be smart if getting the oil were like getting gold out of Fort Knox. The fact is that we must produce and refine continuously if we are to have the capacity to do so in an emergency.

The national security issue becomes more intense when we look at the source of imported oil. Members of this committee know—as all Americans know—of the instability in the Middle East. Our oil supply has been shut off in the past, and it may well be shut off at any time in the future. If our foreign policy were a model of clarity and reason, we would still be at the mercy of unreasonable people in the midst of a desperate war and unceasing turmoil. How can we leave our Nation open to a risk that may well become reality?

An oil import fee will not solve all the problems in the oil patch and will not make us invulnerable to troubles in the Middle East. It will, however, help to revive a reeling domestic oil industry. It will put back to work thousands of people throughout the Southwestern United States. It will serve notice on foreign suppliers that they cannot continue to sell oil to the United States at predatory prices. It will counter the idiocy of spending $140 a barrel to protect that barrel of oil shipped from the Persian Gulf when it can be bought in the United States for $19. It will help to reduce our trade deficit. It reduces the costs that we bear in protecting the oil supplies of our major trade competitiors, and they are not sharing in that cost. And it certainly will bring revenue to help us toward the goal of a balanced budget. This tax bite will not be put upon the people of the United States, but upon foreign suppliers who have proven that they will not hesitate to strangle the American economy if they perceive it to be to their advantage.

Mr. Chairman, as the committee considers revenue measures to meet our budget requirements, I urge it to choose the oil import fee as an option.

Mr. ANDREWS. Mr. McCurdy, there are those that have claimed that an oil import fee would be inflationary, and I wonder if you would comment on that criticism of an import fee. If we impose some kind of fee, say $25 per barrel variable fee, would that have an inflationary impact on our economy?

Mr. MCCURDY. Mr. Andrews, as you know, and I think many people have seen, there are a number of options out there for an oil import fee. Some of those that I think are probably the most prudent have a variable fee. In other words, it goes up to a limit, and the fee would equal the difference between the world price of oil and the $25 per barrel.

Thus, you know, if the world price reaches the $24 per barrel, then the fee goes to zero. So I do not think that would be inflationary. I think that that is built in. There is a ceiling on it.

We also have to remember it has not been that long ago that we had much higher oil prices than we do today, and I think the American public became relatively accustomed to that. The fact of the matter is that there are bargain basement prices there today which we could take advantage of when the time is ripe for such a fee. Again, I think it makes sense to have it at a variable rate, set a price, $24 per barrel is less than what we were paying a few years ago by a long shot. At the same time you are protecting a domestic industry. At the same time you are raising revenues.

You know, everybody comes up here, most of the people come up here and ask for a tax or they are proposing a tax because that is a tax on an industry in their state. Well, we are telling you you have an opportunity to raise revenue and protect an industry at the same time.

Mr. ANDREWS. Well, the truth is, one reason I think most proponents of an import fee like the variable proposal is that when the price does get to, say, $24 a barrel—if that is the rate—the fee is zero. So the inflationary impact, if there is a negative impact, could be capped. We can gauge what the macroeconomic impact will be on the economy.

A second criticism of the fee has been the impact on consumers—that in fact the fee would hurt consumers especially in other parts of the country other than the producing States. I wonder if you would comment on that criticism.

Mr. McCURDY. That is a good question, and it is a legitimate question to ask. We do not want to place a burden. We are not trying to shift a burden from one region to the next. As I said earlier, because of the relatively cheap price of gasoline—it is cheap compared to what we in the United States experienced a few years ago, and it is also incredibly cheap compared to European costs and foreign costs of gasoline. You know, a dollar per barrel increase on crude would result in perhaps 2.5 cents at the pump per gallon. I do not think that that is spreading the burden, and I think it is also to point out again, as a member of the Intelligence Committee we were having briefings recently on the Persian Gulf. I asked the admiral in charge what was the cost of us defending that oil flowing through the Persian Gulf. John Lehman, former Secretary of the Navy, estimated some $40 billion. When we calculate that by the 330 million barrels of oil that we import, you are talking about $140 a barrel to protect whose oil? We only get 10 percent of our oil from there. We are protecting 80 percent of Europe's and Japan's oil. Talk about putting the burden on the consumer. I mean, that is where the burden is, the tax burden from another source.

So I do not think that that argument today there is much credibility.

Mr. PEASE. Would the gentleman yield?

Mr. ANDREWS. I would be happy to yield.

Mr. PEASE. I appreciate the gentleman yielding. Mr. McCurdy, if there were an oil import fee, just for example, of $2 a barrel, and the world price were $20 a barrel, imported oil would then become $22 a barrel. Is that correct?

Mr. McCURDY. That is correct, yes.

Mr. PEASE. Well, what do you think, then, domestic suppliers would sell domestic oil at? What price?

Mr. McCURDY. Well, of course, they are going to cover their costs, and the idea, of course, is for the domestic price to increase, quite frankly, Mr. Pease. There is no secret about that. That is the design.

What you are doing is trying to raise that price to a level that you maintain a level of production that keeps that industry viable, but at the same time is there in case of an emergency or whatever options you have.

Mr. PEASE. So essentially, it would be an out-and-out $2 a barrel subsidy for domestic producers?

Mr. McCURDY. It would be a price stabilizer, and there are floors, and there are floors in a lot of industries. I think that is a far less subsidy than subsidizing foreign oil at the rate of $140 a barrel going to Japan or to Europe, because we are defending it, not our allies. They are not defending it. They are not escorting ships in the Persian Gulf today, but we are.

I think that it would be a much cleaner and straightforward way of protecting an industry.

Mr. **Pease**. I am just trying to understand what it is. Can you tell me roughly what U.S. domestic production is now?

Mr. **McCurdy**. I am sorry?

Mr. **Pease**. What is the daily U.S. domestic production of oil right now?

Mr. **McCurdy**. Total barrels? I think it is about 8 million a day, my colleague from Texas says.

Mr. **Barton**. 7.8 million barrels per day.

Mr. **McCurdy**. It is more than 8, you say, or about 8?

Mr. **Barton**. A little bit less than 8; between 7.75 and 8 million barrels per day.

Mr. **Pease**. Domestic production?

Mr. **Barton**. Yes, sir.

Mr. **Pease**. Including Prudhoe Bay. What are imports right now?

Mr. **Barton**. Imports are about 6 million barrels per day.

Mr. **Pease**. 6 million barrels a day.

Mr. **McCurdy**. Which is a higher percentage today than it was in 1979.

Mr. **Pease**. Yes. Well, it certainly disturbs me that we are relying so heavily on imported oil. My understanding is, however, that there is a limit to how much we can expand domestic production no matter what the price is. Do you have any idea what that limit is?

Mr. **McCurdy**. If the gentleman will yield, I am sure my colleague from Texas would love to take a swing at that one, also. If my district were a State, it could conceivably be the tenth largest crude oil producing State in the United States. Yet we have 10, 12 percent unemployment in those areas, and there are vast reserves there that are untapped.

More importantly, in the crude oil area—in the natural gas area there are tremendously incredible reserves there, but the price keeps it in the ground today. In the crude oil sector, most of our production is from stripper wells, secondary and teriary recovery.

What that means is that we know where the oil is. It has been discovered. We know the zones, and we have been producing it. But it takes other than just drilling a hole, which many people do not understand. Most people think you just go out and drill a hole and the oil comes out. It does not work that way. We have to use enhanced oil recovery methods to extract that oil. That is why it costs more. The cost of producing a barrel of oil in Oklahoma or Texas or in the United States is much greater than it is in Saudi Arabia. Our lift to cost ratio, or the cost there is around anywhere from $13 to $17 a barrel just to get the oil out of the ground.

So that is an investment that has been made. Sometimes it is water injection, gas injection, a number of methods used to help force the oil up. Once the price of oil drops below a certain level—and when we reached $15 and $16 a barrel, that was it. The marginal rate of return was reached. People capped those wells, and it cost money to cap them. Once they are capped, the pressure drops, and we can no longer get that oil back out because it dissipates in the formation.

So what we have done is we have lost the resource. We have lost it. It is not a question of whether or not we can produce oil. We have lost the capability to get most of that oil. So what we are doing is squandering a resource as opposed to saying, well, we will just go out there and waste it. It is better to use it productively in the economy than it is to just let it dissipate into these formations and it may never ever be recovered again.

Mr. **Pease**. If I can ask one more question, I will yield back.

Mr. **Pease**. I understand all that and it certainly is an argument for getting that oil out while we still can. I had understood, however, that the potential for production from stripper wells and that sort of thing is fairly limited and that even if oil were to reach $50 a barrel, the amount of oil reserves available in the United States would mean effectively that we could not produce more than about 9.5 to 10 million barrels a day.

Is that your understanding as well?

Mr. **McCurdy**. It depends again, if you are talking on shore CONUS, continental United States, non-Prudhoe Bay, sure there's a limit, but there are some reserves that have yet to be discovered.

Mr. **Barton**. It is about 1.6 million barrels per day and if you multiply that times $20 a barrel, you get pretty high numbers fairly quickly and, as Congressman McCurdy pointed out, if you cap those stripper wells, then they are gone.

Now there is a percent of the total reserve base, that is about 16 percent of the total reserve base in the United States that you are going to just walk away from, and you can get some pretty substantial numbers on a yearly basis in the billions of dollars fairly quickly.

Mr. **Andrews**. If I could regain my time, Mr. Pease, just to make a point, the National Petroleum Council has estimated that in 1985 we imported about 27 percent of our oil. You made a point that maybe—I believe the significance of your question was maybe we are not importing as much oil as we think, or as Congressman McCurdy implied. They project that in 1990, we will be importing 60 percent of our oil unless we address this energy problem and 68 percent in the year 2000.

One of the central issues I think we have got to focus on in the committee is not just the regional balance of some revenue bill, but what the far reaching national security implications are to our production capacity. I think what Congressman McCurdy is trying to point out, as we cap these wells, we lose these wells. We do not go in and uncap a well. We lose that opportunity.

Mr. **Pease**. Would the gentleman yield?

Mr. **Andrews**. If I could, just let me yield to the gentleman, Congressman Dorgan.

Mr. **Dorgan**. Thank you for yielding. I have to leave in just a couple of minutes and then I will be back, but I did want to remark to Mr. McCurdy that when you talk about the oil import fee, on this committee or to our colleagues generally, it breaks down into two separate reactions.

One is a reaction from people who come from oil producing States, and about all they can see is oil. Their reaction is they are absolutely for it, because they come from an oil producing State.

The other reaction is from someone who comes from an urban area, who reacts only on the basis of what this might do to the consumer bill and generally reacts negatively and quickly to the suggestion. I do not think that is what the issue is. I think that is part of what you are trying to say to this committee.

The issue is not how well off the oil industry is today or yesterday or tomorrow. It is not about what the economy is like in Houston, and the issue is not what will the marginal increase be of the utility bill for someone who lives in Bismarck.

The issue is much, much broader and much more compelling than that. The domestic exploration capacity in this country is dead. I mean, it is absolutely down and dead. If you take a look at any place in the oil patch in this country, it is gone. Strategically, from a national security standpoint, that is extremely foolish.

We debate so many economic questions here, in the context of tax law. I do not care whether you are talking about steel production or oil production or a series of things that I think are vital to the long term health and security of the American economy, you have got to be concerned about the major pillars of our economy, and one of them is the ability to domestically produce adequate supplies of energy.

I think that is what the issue is when we talk about an oil import fee. I think it is not so much a regional question, it is a national question. There will have to be some regional balance in the impact of what we do on this committee this year. I understand that. The impact has to be regional versus the consumer in Ohio versus the consumer in North Dakota. It is in the North Dakota consumer's interest and the Ohio consumer's interest for us to have a domestic energy industry that is capable of exploring and discovering new sources of energy for our national security.

Mr. McCurdy. If the gentleman would yield on that point, I would just like to point out one thing, and that is the domestic rig count, and that is the number of drilling rigs that are in this country, dropped from approximately 4,500 in October of 1981 to under 800 today. We had more than 800 in Oklahoma at one time, alone. They are obsolete.

The worst sign in our part of the world is when you see a bunch of oil rigs and they are stacked. They are laying on the ground, flat. That is a bad sign. Those are expensive piece of equipment and they are resting and the FDIC owns most of them right now anyway. We are losing that capacity and that is a very dangerous sign.

Mr. Pease. Now would the gentleman yield?

Mr. Andrews. I would be happy to yield?

Mr. Pease. First of all, I appreciate those comments and I would just point out to my friend from Oklahoma that much of the tubing, which is used for drilling oil wells, comes from Lorain, Ohio, in my district and from a steel mill that has gone from 8,500 employees to 1,700 in the last 6 years, largely because of the collapse of the oil drilling operations.

So I am not without some personal interest in having the oil patch become more effective once again.

But the point I want to make, and I think we need to keep in mind, Mr. Chairman, is that no matter what we do to encourage oil production, an oil import fee or whatever, no matter how high oil prices per barrel get, there is a limited amount of oil in the United States to be gained. And we will probably be importing over 50 percent of our oil by 1990 or 1992, no matter what happens because effectively we cannot produce more than about 9.5 million barrels a day in the United States, no matter what.

So that axiomatically, when our consumption gets up to 18 or 19 million barrels a day, we are going to be importing half of it.

Mr. McCURDY. Would the gentleman yield on that point?

Mr. PEASE. Sure.

Mr. McCURDY. The gentleman makes a good point. I would take exception to some of the figures on the overall capacity to produce and, if I may, I would like to submit later to the committee, for the record, some testimony or some statements as to the exact figures of what the estimates are, and they would vary. I mean, different scientists and the Energy Research Center at the University of Oklahoma has that in its own computer and I will be glad to furnish more than you would probably like to have.

But I think it is important that we consider, when you are talking about consumption, that price does have an impact on consumers and on the consumption of gasoline. I know people are talking about excise taxes. Excise taxes are regressive.

It makes sense to me that this is an opportunity, or it seems to me this is an opportunity to do a number of things. One is you protect an industry, whether it is tubing manufacturing in Ohio or oil production in Oklahoma or Texas, but you also are raising money to help reduce the deficit. But more importantly, the money that is spent on that energy, even though some of it may not go directly to the government coffers, stays internally in the U.S. industry as opposed to going to Saudi Arabia or Kuwait or Iraq or Iran, to their government coffers.

So what I am arguing is that if we want to reduce consumption or we believe that the price is artificially low today, why do we not take advantage of this opportunity, because of the low price, to help stabilize that price at a level that may become moot.

We have the so-called windfall profits tax that is not kicking in right now. Of course, we would like to see it repealed because it is no longer effective and civil code windfall is no longer there. It would be nice if you could address that issue, too. We would love to see it repealed.

But the point now is that we are at a low price. We have an opportunity to do a number of things. It is a pretty neat package and maybe you have to trade it off. Some of us realize there may have to be a tradeoff with some other states to offset some of the impact on consumers. But I can assure you the impact is not that great and it would have a very positive impact for the consumption within the country.

Mr. PEASE. Thank you, Mr. Chairman.

Mr. ANDREWS. Mr. Duncan.

Mr. DUNCAN. Mr. Chairman, I want to thank all of the panel. I have generally supported the oil industry more from a tax incentive than otherwise. We have had testimony recently in communication with people in the petrochemical industry which indicates that they are having a tough time now in competing with foreign imports, and that if we put a greater tax on them, that there is no way that they can.

A lot of us, I suppose, throughout the United States, have a great interest in plastics and other petrochemicals, as to what it would do to them. Would one of you care to elaborate on that problem?

Mr. McCURDY. The only point, and I would let my colleague from Texas respond, too, there are a number of macroimpacts of anything. Anything you all do in this committee has tremendous macro impact and we all understand that.

But at the same time, if there is a tax, you are losing refining capacity. It is difficult for me to imagine that they are arguing one, that we are having such a negative impact when most of them are going out of the business anyway. They have become more reliant, in the petrochemical industry, on imported sources because there are so many domestic refineries that are closed down.

Those domestic refineries, again, heaven forbid an emergency situation—and I know it is totally inconceivable, but what happened if Iran happened to gain a little more territory in Iraq and then went into Kuwait and Saudi Arabia defends Kuwait. Do you think the Persian Gulf is going to be a stable source? Do you think the pipelines running across Iraq and Saudi Arabia are going to be stable?

Talk about the impact, we cannot turn it on overnight. Sure, we had the SPRO, and there is some question how effective the SPRO is, but we are losing that refining capacity which is the suppliers to those petrochemical industries.

So I have a hard time understanding their plight, to be honest.

Mr. BARTON. If I could try to address it just very briefly, Mr. Duncan, there are a couple of points. No. 1, the petrochemical industry is profitable in this country. The drilling and exploration industry is dead. I can provide the exact numbers for you, but petro chemicals did make money last year.

No. 2, their competitors in foreign markets do not operate under the same EPA guidelines, environmental guidelines, that our companies do here in the United States, so they are already at somewhat of a competitive disadvantage because of that.

The third point, I cannot relate to all the oil import fee proposals, but my variable rate fee gives an exemption for petro chemical companies that import crude, refine it, and then export the resulting products, so they would not pay the fee.

Mr. DUNCAN. Thank you. Thank you, Mr. Chairman.

Mr. ANDREWS. Mr. Moody.

Mr. MOODY. No, what I heard was very good. I also am supporting an oil import tax. In fact, in testimony later on, I will be saying much the same thing that you said, so I will let it go. No questions.

Mr. McCURDY. I thank the gentleman. I would call for a vote today.

Mr. ANDREWS. I would like to ask Congressman McCurdy one more question. The Department of Energy issued a report that concluded that the cost of an oil import fee would far outweigh any energy security benefits to our country. I wonder if you would address the merits of that report, its impact on the economy, and some of the things that the report may have failed to mention.

Mr. McCURDY. I thank the gentleman for asking the question and I think it is important, for the record, that we clarify that. It is clear that the current administration, the Reagan administration, opposes an oil import fee. I think when the Department of Energy made this study, they probably took that consideration into fact, that fact into consideration.

I think there are a number of flaws within that report. As a matter of fact, I saw some statements by an economist at the Harvard-Kennedy School as well as some analysis by the Senate Budget Committee that indicates that the DOE in that report actually erred through its combination of the results, combining the results of macroeconomic analysis and microanalysis in measuring the costs and benefits of the oil import fee on the economy.

Using DOE's own assumptions and estimates in a valid cost benefit analysis, a $5 per barrel oil import fee would produce a minimum of $23.8 billion in net benefits to the economy. The losses, however, of about $2.9 billion as a result of increased prices, which if my math is correct, the difference is $22 billion positive result plus untold results from a national security standpoint.

As Hogan points out, the DOE treats the $10 import fee as a surprise. In other words, an oil price shock as an annual occurrence through 1995. In fact, that would not be an annual price shock because the economy would actually adjust to that tariff as it has in many other cases.

So I think that report was flawed. I think also the report fails to take into consideration that an oil import fee, by increasing domestic energy values, would also encourage development of alternative energy sources, as my colloquy with my friend and colleague from Ohio, Mr. Pease, about the consumption. This would result in increased jobs in the alternative energy area and, in time, develop alternative sources of energy to oil, which I think is a fact that he is concerned about.

The DOE report also did not compare the effects of alternative revenue raising or spending reduction proposals with the import fee. In other words, offsets to the overall budget and the positive impact of increased employment, et cetera, et cetera.

The DOE did not analyze the impact of the variable fee under their higher priced scenario. In other words, they pegged it on one price, as opposed to a variable fee. Thus, as a result, their study assumed that the import fee would remain in place through the entire period.

So again, there is an old saying, as one who studied international economics in Europe for a year, figures do not lie, but liars can figure. Sometimes I wonder how they came up with the results that they did, but I think they had a conclusion in mind.

So I think there is a number of reasons to indicate that the DOE report was not terribly objective.

Mr. Andrews. Thank you, Congressman McCurdy.

Congressman Kasich.

STATEMENT OF HON. JOHN R. KASICH, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OHIO

Mr. Kasich. Thank you, Mr. Chairman.

I want to talk to you briefly today about a proposal that will generate a significant amount of revenue, but yet not increase any taxes. As Mr. McCurdy said to me earlier, it is a good Republican stand, I suppose. I want to make it clear this has been a bipartisan effort.

It involves the IRS offset of income tax, something that we have had in effect for a couple of years. It was put in the Deficit Reduction Act of 1984. This idea has been implemented in nine agencies of the Government. Under this program, if you have money coming back from the IRS, but you owe money to the Federal Government, there will be an offset, or an offset will occur. Over the last 2 years, this program has brought into the Federal Government nearly a half a billion dollars.

The problem is that this particular regulation is going to expire at the end of this year. What we really need to do, as I proposed in a bill that I introduced several months ago, is extend the time period for the IRS offset program. We want to extend it for two additional years.

It is estimated that we brought in almost a half a billion dollars over the last 2 years. We anticipate collecting that amount over the next year alone because one other agency and nine new programs will be added to the overall program. The estimate of revenue increase as a result of this is about $424 million.

So we are going to see a significant increase in the amount of revenue that the Federal Government can bring in, in 1 year, as a result of continued momentum of this program.

Now Mr. Chairman, the problem is that we have got about a $68 billion total delinquent debt problem in this country. This is the great untold story or the great unrecognized problem in this country. Literally, $68 billion in unpaid debts by individuals and corporations. That has gone up $10 billion in the last year.

Here is what will really blow your mind. Over the last 3 years, the Federal Government wrote off $9.7 billion in delinquent debt that it says it no longer can collect. I can assure you that there was no mechanism ever applied to try to collect this $9.7 billion, so we might as well have taken $9.7 billion, stood on top of a building, threw it up in the air and let it come down in a canyon somewhere where no one could ever get at it.

This IRS check off is the single most effective tool available to everyone in the Federal Government as a last resort to prohibit delinquent debtors from being able to avoid their obligations; 82 percent of the American public, when questioned about this program, particularly when applied to the Department of Education, said that they support it. I think that's because 95 percent of those who receive loans pay them back. But 5 percent decide to walk away.

The IRS check off program is going to force people to pay their money back and forces them to meet their obligations.

I have letters from OMB Director Jim Miller, Treasury Secretary Jim Baker and Education Secretary Bennett, all of whom indicate their strongest support for continuing this program.

The significant thing is that we can pick up, next fiscal year, about half a billion dollars without doing anything other than making taxpayers happy and delinquent debtors probably uncomfortable and maybe mad. But I do not think that they have a right to be able to get loans and obligations from the Government and walk away.

I also want to point out that we now have about $1.3 trillion in Federal Government potential obligations outstanding now. You know, credit via the Federal Government is the fastest growing area in the Federal Government. We must have a comprehensive system for managing the allocation, the management, and the collection of moneys that are owed to the Federal Government. We've tried to do a number of things in this area over the last several years and some of it has been effective. But this tool is the single most effective one available to collect these dollars.

Before we even begin talking about tax increases, oil import fees, luxury taxes and everything else, we need to extend this program. We can bring in half a billion dollars next year and if the program continues to be successful, I anticipate that number will go up, so we can bring in $1.5 billion over the next couple of years by doing nothing more than efficiently managing the credit of this Nation.

We would be silly not to. I ask for your support. I think we are going to have strong bipartisan support for this extension. I want to point out, Mr. Chairman, Diane Dogan is in the back here. She is the administration's debt czar. She has been appointed to coordinate out of the Treasury Department an effort to manage this entire $1.3 trillion in Government obligations to make sure that we develop efficiencies in our agencies and our departments and our bureaus.

I really appreciate having the opportunity to come before the Ways and Means Committee. This is the second or third committee I have been before. We have attached amendments to authorization bills in an effort to improve this overall area, but I think you can see that when, in 3 years, we write off almost $10 billion, and we have got so much outstanding, we have got to do everything that we possibly can to bring in as much revenue as possible, and ensure that all the agencies of Government have this very effective tool.

I appreciate the opportunity to be here.

[The statement of Mr. Kasich follows:]

REMARKS BY CONGRESSMAN JOHN R. KASICH BEFORE THE HOUSE WAYS AND MEANS COMMITTEE TO EXPRESS SUPPORT FOR EXTENSION OF IRS AUTHORITY TO OFF-SET TAX REFUNDS FOR DEBT COLLECTION

JULY 15, 1987

Mr. Chairman, I would like to thank you for this opportunity to express my views regarding the need to extend the authority of the Internal Revenue Service (IRS) to off-set income tax refunds for the purpose of collecting overdue debts owed the Federal government. I believe this hearing provides an excellent occasion to review the off-set program, which was originally enacted in the Deficit Reduction Act of 1984, as current authority to off-set refunds expires on December 31, 1987. I would also like to point out to the committee that quick action by Congress would allow this highly successful program to continue without interruption.

As the sponsor of H.R. 2367, which reauthorizes the off-setting of tax refunds for two more years, I strongly believe this program should be continued as it has proven to be one of the Federal government's most effective tools in collecting delinquent debts. During the past two years, the off-set provision has been responsible for collecting, either directly or indirectly, almost $450 million. In the 1987 IRS refund cycle, nine Federal agencies (Agriculture, Defense, Education, Health and Human Services, Housing and Urban Development, Justice, Small Business Administration, Treasury, and Veterans' Administration) referred to IRS over 1.1 million delinquent accounts valued at $2.36 billion, and 41 percent of these accounts had refunds withheld at an average of $471 per off-set. Equally important, voluntary repayments in 1986 and 1987 amounted to almost $83 million as thousands of taxpayers decided it was best to fulfill their financial obligation rather than risk the loss of their tax refund.

These successes have been achieved without disrupting IRS' tax administration activities and at very little cost. A General Accounting Office study of the first year results shows that for every dollar spent on this program, the government has recovered $150 in delinquent money.

Obviously, the IRS off-set program has been a tremendous success and projections for the third year of the program point to continued progress. If the off-set provision is extended for next year, the number of agencies participating is expected to be expanded by one, and nine new programs will be referring delinquent debts to IRS for collection. In addition, these ten Federal agencies will be forwarding 1.4 million accounts totaling $3.01 billion. According to the Treasury Department, collections next year are estimated to total $424 million.

Although past revenues and future revenue projections have significant implications on our budget deficit, I believe the off-set program is equally important because it clearly indicates the Federal government is committed to collecting delinquent debts from those who have the ability to pay. As mentioned earlier, simply sending notices that refunds would be withheld has accounted for almost $83 million in collections and has resulted in many taxpayers suddenly finding the resources to pay overdue debts. In one example, a recipient of an off-set notice walked into a Small Business Administration regional office in Ohio and repaid his $23,000 loan in full. This case was repeated thousands of times because defaulters finally came to realize that they could no longer avoid paying their government debts.

The off-set program also deserves reauthorization because the American people support the actions of the Federal government to force delinquent debtors to pay their debts. In a September, 1985 Gallup Poll, 82 percent responded that they supported the withholding of Federal tax refunds from persons that have defaulted on student loans. The public clearly understands that failure to repay money that was lent in good faith is wrong, and all reasonable efforts to collect these dollars owed are justified. The American people also realize that failure to repay loans robs needed assistance from the next qualified recipient and steals from all other taxpayers who are forced to pick up the costs of these defaulted loans.

In addition, it is my understanding the extension of the off-set provision has the support of the Internal Revenue Service, the Office of Management and Budget, the Treasury Department, the Department of Defense, and the Department of Education. In fact, I have received letters from Secretary Baker, Secretary Bennett, and Director Miller expressing their support in this matter. In Secretary Bennett's correspondence, he claimed the off-set program has been highly successful for the Department of Education, both in terms of collecting debts and for providing a deterrent to potential defaulters.

In my opinion, it is clear the IRS off-set effort is highly successful by any measure. **However, the effectiveness of this valuable program may be reduced if Congress does not take immediate action to reauthorize IRS authority.** The Department of Education, which has collected more than $320 million during the last two years through the use of the off-set program, has announced that if Congress does not extend it by August 15, 1987, the Department will not be able to use this highly successful tool against 1988 refunds. Although current statutory authority does not expire until December, 1987, the urgency results from the Department being required to provide debtors with due process notification, the very large number of debtors affected by the off-set, and the inability of starting this notification process before the law is actually reauthorized. First, Education must provide debtors with due process protections which require three to four months to complete. The statute, 31 U.S.C. 3720 A (b), requires the agency to provide each debtor with notice of the debt and the proposed off-set, with at least sixty days to present objections to the off-set, and with an administrative review of those objections. The department implemented these due process requirements with regulations which assure the debtor not only the required notice and administrative review, but an appropriate opportunity to inspect records, and an opportunity to enter into a repayment agreement in order to avoid off-set. It should also be pointed out that the Department of Education must rely on the assistance of various guarantee agencies operating under the Guaranteed Student Loan Program to provide initial reviews to many debtors. Furthermore, in accordance with the off-set agreement with IRS, Education provides any debtor dissatisfied with the decision of the guarantee agency a thirty day period to request an additional review by a department official.

Not only do the statute and department regulations establish due process procedures that usually take longer than sixty days, IRS regulations require all agencies to have this notice review process completed before each debt can be referred for collection. IRS regulations set a December 1 deadline for referral of accounts to the IRS for off-set against future refunds, and do not permit referrals after that deadline. The IRS has in fact delayed this deadline to early January these past two years, yet this time frame still requires Education to start the notification and review process months in advance.

Thirdly, since this notice and review process must be given to 1.3 million debtors, Education must start the required procedures even earlier to accommodate the expected volume of requests for documents, reviews, and repayment terms. In fact, due to limited staff resources the past two years, not all requests from debtors could be honored in a timely basis, and some debts were not referred for off-set. If Education cannot begin the process early enough to stagger over several weeks the mailing of the preoff-set notices needed to start the process, it will be overwhelmed by the volume of responses from debtors and will never be able to process all requests properly. Not only will this frustrate debtors who object to the off-set or those who are willing to enter into repayment agreements, it will prevent referral to the IRS and collection of thousands of debts that would have to been found, on review, to be valid obligations.

Finally, Education claims that it cannot start the preoff-set process before the law authorizing off-set takes effect because it cannot lawfully threaten an off-set, if it lacks the authority at the time it makes the threat. The agency contends that a threat to collect under an authority it does not have is arguably misrepresentation, and can be expected to be promptly challenged in court if attempted.

While I am not aware of any other agency expressing so forcefully its inability to use the program if Congress does not act in a timely manner, it is clear the required due process procedures are an important factor in Congressional action on this program. In other words, not only should the committee extend the off-set program for two more years, it must do so in an expeditious manner. If Congress hesitates to act quickly, I am concerned the efficient operation of this valuable collection tool could be affected and our inaction will reinforce the notion that the Federal government is not really serious about collecting its delinquent debts.

Mr. Chairman, I support the extension of the off-set program because it has been very successful and it represents an important step in collecting overdue government debts. This program, however, must be supplemented with a reformed credit management and debt collection system that is implemented throughout the Federal government. According to the Office of Management and Budget, Fiscal Year 1986 ended with $68.3 billion being owed the Federal government in overdue debt -- an increase of 129 percent since 1981. As disturbing as these numbers appear, the future may be even worse when one realizes the government has lent, directly and indirectly, over $1.2 trillion to millions of individuals and businesses, and these dollars will be coming due in the years ahead. In just the last year, the government's delinquent debt has grown by $10 billion.

While the single largest amount owed--$41.9 billion--is due primarily to the Internal Revenue Service for back taxes, the remaining balance of almost $30 billion is spread literally throughout the government. In other words, the sheer width and breadth of the overdue debt problem is just as astonishing as the amount which is overdue. A review of delinquencies reveals that government makes financial assistance available to just about everyone to do just about anything. In far too many cases, however, government loan and credit assistance programs have only been concerned with providing financial help as quickly as possible. With so much emphasis being placed on spending taxpayers' money, little or no consideration has been given on how to efficiently collect what is due.

Despite Congress enacting the Debt Collection Act of 1982, the Federal bureaucracy is still experiencing major problems in debt collection. This Act took an important step by authorizing agencies to use private collection services. However, it took almost three years for the bureaucracy to write the necessary regulations to implement this provision. The significance of this delay is further magnified when you consider that delinquencies almost doubled during this same period. In addition, most government agencies have such inadequate internal accounting controls that in many instances there is very little information available on the status of debts and whether they are collectable. Without such a basic accounting framework, it is not surprising that a recent GAO study found 11 agencies (Agriculture, Commerce, Defense, Education, HHS, HUD, Justice, Labor, Interior, SBA, and Transportation) reporting major problems in debt collection. Collectively, these agencies administer about 92 percent of the government's delinquent non-tax debts. Furthermore, the Federal government has written off $9.7 billion in delinquent debt over the past three years with no clear assurance that every possible action was taken to collect this debt.

In agencies where appropriate debt information can be provided, bureaucratic delays and lack of litigation resources have hampered collection efforts. In addition to private collection agencies, another important tool in improving collection efforts is the ability to use legal suits to force payments. The Department of Justice's litigation efforts, however, have been slow, ineffective, and inefficient. In fact, the Justice Department has a backlog of 103,000 debt cases, a number which has increased by 24,000 cases during the past two years.

At a time when Gramm-Rudman-Hollings is forcing Congress to examine all Federal spending programs, I find it inconceivable that appropriations for popular programs will be cut, yet billions of dollars owed the Federal government continue to go uncollected. Congress can no longer afford to permit these funds to remain uncollected, and immediate action is essential if the problem is ever going to be brought under control.

Based on my research and the valuable assistance provided by the General Accounting Office, I have found the government's debt collection crisis is primarily due to several major factors including: (1) improper screening of participants in loan programs, (2) incompetent administration of loan portfolios of those who have the ability to repay the debt, (3) insufficient use of private collection agencies and other means to ensure collection from delinquent debtors, (4) lack of resources dedicated to litigation efforts and enforcement of court judgments, (5) lack of intragovernmental cooperation to obtain current debtor information, and (6) inadequate accounting methods and systems.

Due to the complexity of the debt collection crisis and the multitude of problems involving bureaucratic inaction, I am convinced only a comprehensive response by Congress will dramatically improve collection efforts. Any solution must contain these components:

* appointment of a "debt czar" who would be responsible for debt collection and credit management throughout the Federal government;
* a mandate that all agencies establish specific management systems to ensure proper and timely administration of credit assistance and debt collection;
* adoption of current collection practices used in the private sector and the sale of debt portfolios to private investors or collection agencies;
* additional tools for the Justice Department and other agencies that will allow stepped-up litigation efforts;
* new statutes that prohibit delinquent debtors from continuing to receive additional Federal assistance;
* budgetary incentives for Federal agencies to improve debt collection;
* the sharing of debt-related information between government agencies to ensure timely collection.

Mr. Chairman, as bad as the debt collection crisis appears to be, there has been some progress in this area that deserves recognition. Congress has given approval to a pilot program in the Justice Department that will permit the use of private law firms to assist in debt litigation and the Department of Defense is now required to use private collection agencies for overdue debts. During the past several months, the House has also inserted amendments in several authorization bills that are designed to expand the use of collection agencies and improve the referral of debt information to credit reporting agencies. Late last year, the Reagan Administration designated the Treasury Department's Financial Management Service as the lead agency to coordinate the Federal government's debt collection and credit management programs. My hope now is that this committee will continue the commitment to address debt collection problems by reauthorizing the IRS off-set program as soon as possible. If not, Congress may be letting 700,000 taxpayers off the hook, and may cost the U.S. Treasury almost a half billion dollars.

Thank you, Mr. Chairman, for this opportunity to express my support for the IRS off-set program and to discuss the Federal government's delinquent debt problem. I would be glad to answer any questions the committee may have.

Mr. ANDREWS. Thank you, Mr. Kasich. We really appreciate your testimony.

Mr. KASICH. Mike, let me say one more thing to you before we move on. We are going to have to move quickly on this. I am not a lawyer but I was taking a look at these procedures that are involved in the checkoff program. For example, the agencies have to notify each debtor about the offset. They have got to give them 60 days to present objections to the offset with administrative review of those objections.

They then have to give the debtor an opportunity to explain why they have the debt or why they should not have the debt. Then they have to give them the opportunity to make arrangements as to where we should go. The problem is that, because of these procedures every day we wait beyond the first of August, renders the program less and less effective.

What we do not want to do is to lose half a billion dollars in revenue next year because we were fiddling around here and we were not able to move this kind of legislation.

What I want you to know is the statutory requirements that are forced on the Government entities that want to have this kind of a program, in terms of due process for the agencies, due process for the debtors, is so extensive that if we wait a long time we will kill the effectiveness of a program and deny ourselves an awful lot of revenues that we can have by just being efficient.

Thank you, Mr. Chairman.

Mr. ANDREWS. I appreciate very much your testimony.

Congressman Joe Barton.

STATEMENT OF HON. JOE BARTON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

Mr. BARTON. Thank you, Mr. Chairman.

I am assuming you have the proxies, so I am going to call for a vote on my proposal immediately after presentation.

In the late seventies Americans were spending quite a bit of time, as you know, waiting in gasoline lines. Oil prices were at an all time high. Oil imports were over 40 percent, and President Carter declared that the energy crisis was the moral equivalent of war. Our energy future looked bleak. In the early 1980s, another President, Ronald Reagan, proclaimed a reliance on free markets. Oil prices declined, supplies increased, and the country adopted a "what-me-worry?" attitude towards energy.

What is the situation today? America is becoming dangerously reliant on imported energy sources once again. American oil production is down by 900,000 barrels per day since January of 1986, and is continuing to decline. This is a 10 percent reduction in our domestic production.

As our domestic production has gone down, imports have risen by 1 million barrels per day or approximately 25 percent over the same time period. As you know, and as you pointed out in one of your questions, at this pace, we will depend upon imports for 50 percent of our oil needs within 2 years.

This will be an all time high dependency ratio.

The threat to U.S. energy security arises not just from the volume of imports but also from the sources. Oil imports from the Organization of Petroleum Exporting Countries or OPEC and particularly from Saudi Arabia have skyrocketed. Overall, OPEC exports to the United States rose by 51 percent in 1986 while non-OPEC oil sources such as Great Britain and Canada declined by approximately the same amount.

American oil production is down because world oil prices collapsed in 1986. Prices peaked at $42 a barrel in 1982. Since that time, they have slowly but surely declined until 1986, when they literally plunged through the floor, bottoming out at below $10 a barrel last summer.

This plunge in prices was part of a carefully calculated strategy by OPEC to force a substantial reduction in the U.S. domestic production capacity by causing the premature abandonment of marginal producing properties such as the stripper wells that Congressman McCurdy was referring to. They also wanted to accelerate the erosion of the U.S. domestic reserve base by making exploration financially unattractive.

The overall goal of OPEC was, and is to increase permanently their world market share. This strategy is succeeding.

With the decline in price, increasing segments of our Nation's marginal production capacity are becoming uneconomic. Unlike other commodities which can be turned off and on with the flip of a switch, domestic oil production is not that way. Many stripper wells cannot be restarted. Once their production is terminated, the reserves they represent are permanently lost.

Given the fact that stripper wells account for 14 percent of our current production, and 16 percent of the U.S. reserve base, this loss cannot be taken lightly. According to the estimates by the Department of the Interior, over the next year, from 1 million barrels per day to 1.6 million barrels per day could be lost.

Ultimately, America's domestic production could be reduced to as little as 6 million barrels per day. This would be, in percentage terms, a drop of almost 32 percent from the 9 million barrels per day that we were producing in January of 1986. As you pointed out, Congressman Andrews, this could bring our import demand up to as much as 60 to 70 percent of our domestic requirement by 1990 or 1992.

Currently, we are importing 6 million barrels per day. This is a 1-year increase of 994,000 barrels a day, or nearly 20 percent in the last year and a half.

There is a simple way to boost domestic oil production and reduce our dependence on oil imports. That is an oil import fee. There are costs involved. Congressman Pease pointed out some of those costs. But the question really should be what are the benefits? What are the costs? And do the benefits outweigh the costs?

Earlier, in this session of Congress, I introduced the Energy Independence Act of 1987, H.R. 2200. The goal of this act is to impose a variable rate fee on imports of crude oil, petroleum products, and use the revenues for deficit reduction in energy security programs. Let me briefly outline the aspects of my proposal.

First, we would establish a world floor price for oil at $25 a barrel. I will point out that today the spot market price of oil broke

$22, $22.09. So under my proposal, we would be $3 a barrel above the world price, at least on a spot market as of today. This is a variable fee. If the market price goes above $25, the fee goes away.

Of the money that is collected, 25 percent of the revenue would be used to purchase domestic stripper well oil at $25 a barrel and put it in the strategic petroleum reserve. The remaining 75 percent of the revenues would be used for deficit reduction.

We would require that the purchased stripper well oil be put in the strategic petroleum reserve and increase the fill rate to 100,000 barrels per day. We would also increase the size of the strategic petroleum reserve to 1 billion barrels from the current 750 million barrels.

If H.R. 2200 were law today, the daily revenue based on a market price of $20 a barrel would be about $32 million, $31.8 million. The fee would generate $12 billion on an annual basis, 25 percent of this, or $3 billion, would go to fill the strategic petroleum reserve with stripper well oil, and the remaining 75 percent or $9 billion would go for deficit reduction.

This legislation has a number of benefits. No. 1, it would lower America's dependence on foreign oil. It would strengthen the U.S. domestic oil and gas industry. And it would create new revenues to balance the budget through deficit reduction.

There are other benefits as well. Our trade deficit would be much smaller with this oil import fee and the price that we pay for oil today, imported oil, is our No. 1 balance of payments deficit causal factor. We would reduce our cost for imported oil by about $7 billion per year.

We would also create jobs in the United States. It has been estimated that as many as 400,000 jobs would be created. Some of these jobs would be in oil and gas, but some of them would not be, as Congressman Pease was pointing out. Some of those laid off steel workers would be recalled to the steel mills of Ohio and Illinois and the Northeast. These jobs would boost our GNP and revenues would flow to all sectors of our economy.

A variable rate fee, such as mine, would also bring some stability to oil markets. Lee Iaccoca, chairman of Chrysler Corp., has publicly stated that his company can build cars designed for $10 a barrel oil or $30 a barrel oil, but not both. A $25 variable fee would set a target price for oil and the world price would tend to gravitate to that amount, to that level. That would bring some stability to the world oil markets.

It would also maintain the reserve base of our stripper well production. We would not lose those 1.6 million barrels of oil today that is currently being produced from stripper wells. An oil import fee should be viewed as an insurance policy against any oil supply disruption. The insurance premium would be paid in the form of slightly higher crude oil prices that would naturally result in higher prices for refined products.

For every dollar that we raise the price of crude oil, every dollar per barrel, the price of gasoline at the pump is going to go up somewhere from 2 cents to 4 cents per gallon. So there is a price that has to be paid, but it is like an insurance premium.

Now compare this cost to nickels and dimes per gallon at the pump to the cost that we are paying today to keep the sea lines of the Persian Gulf open. As Congressman McCurdy pointed out in his testimony, we are spending about $40 billion a year for naval and air support in the Persian Gulf.

That is just the dollar cost. It does not say anything about the cost of American lives that have already been lost or may be lost in the future.

In spite of spending this vast amount of money, there is no guarantee that there will not be another supply disruption caused by OPEC. The OPEC countries have had 15 oil supply disruptions since 1948 and each and every one of those disruptions was imposed for political purposes. We only remember 1973 and 1979 because by that time we were very dependent on imported oil, but they have actually done it 15 times.

It is estimated that the 1973 oil embargo lowered GNP by $300 billion. The oil supply disruptions after 1979, the Iranian revolution, lowered GNP by $500 billion.

I would point out that our dependence on imported oil is again approaching the level that it was in 1973 and 1979. According to a report by the Office of Technology Assessment, if we had another disruption similar to 1973 or 1979, our GNP could decline by 10 percent, our unemployment could rise by 6 percent, and we could have a 20 percent increase in inflation.

Since 1973, the oil embargoes that we sustained in 1973 and 1979, the United States has paid out more than a half of a trillion dollars for imported oil and the cost to the economy has been as much as $2 trillion. Now, if you believe that our country will never suffer another oil supply disruption similar to the oil supply disruptions that have been imposed upon us in the past, then this committee should not consider supporting an oil import fee.

However, if you believe that it is possible that we may someday again be subjected to a serious oil supply disruption, then consider the old saying, "You can pay me now, or you can pay me later."

In my opinion, and in the opinion of several of my colleagues in the House, we should be willing to pay now because it will be much less than what we will have to pay later when our oil supplies are disrupted and our economy is in shambles. I prefer to pay a reasonable insurance premium, in the form of a variable rate import fee, and avoid possible future economic disruptions.

I will submit my entire statement for the record, Mr. Chairman, and be happy to answer any questions.

[The statement of Mr. Barton follows:]

STATEMENT OF CONGRESSMAN JOE BARTON

Mr. Chairman and fellow colleagues, in the late 1970's, Americans were spending quite a bit of time waiting in gasoline lines. Oil prices were at all time highs. Oil imports were over 40%, and President Carter declared the energy crisis to be the "moral equivalent of war." Our energy future looked bleak. In the early 1980's, another President, Ronald Reagan, proclaimed a reliance on free markets. Oil prices declined, supplies increased, and the country adopted a "what-me-worry?" attitude towards energy.

What is the situation today? America is becoming dangerously reliant again on imported energy sources. American oil production is down by roughly 900,000 barrels per day since January 1986, and is continuing to decline. This is a 10% reduction in domestic oil production. As domestic oil production has gone down, imports have risen by 1 million barrels per day, or 25% over the same period. At this pace, we will depend on imports for 50% of our oil needs within two years. This will be an all time high dependency ratio.

The threat to U.S. energy security arises not just from the volume of imports, but from the sources. During the last year, oil imports from Organization of Petroleum Exporting Countries (OPEC) members, and particularly from Saudi Arabia have skyrocketed. Meanwhile imports from more secure sources outside OPEC's sphere, such as Canada and Britain, have plunged. In fact, U.S. oil imports from Saudi Arabia rose from a low point of 27,000 barrels per day in September 1985, to 873,000 barrels per day in January 1987. Overall, OPEC exports to the U.S. rose by 51.2% percent in 1986, while non-OPEC oil exports to the U.S. declined by almost the same amount.

American oil production is down because world oil prices collapsed in 1986. Prices peaked at $42 per barrel in 1982. Since that time, they have been steadily declining. However in January of 1986, prices literally plunged through the floor, bottoming out below $10 per barrel in the summer of 1986. This plunge in prices was part of a carefully calculated strategy by OPEC to force a substantial reduction in U.S. domestic production capacity by causing the premature abandonment of marginal producing properties such as stripper wells, and to accelerate the erosion of the U.S. domestic reserve base by making exploration financially unattrative. The overall goal of OPEC was, and is to increase permanently their world market share. This strategy is succeeding.

With the decline in price, increasing segments of the nation's marginal production capacity are becoming uneconomic. In the face of costs in excess of the price the oil will bring from a stripper well, owners are left with little choice other than shutting the well down. Unlike other commodities however, which can be shut down for brief periods of time if necessary and then resume production, many stripper wells cannot be restarted. Instead, once their production is terminated, the reserves they represent are permanently lost. Given the fact that stripper wells account for 14 percent of U.S. production, and 16 percent of the U.S. reserve base, this loss cannot be taken lightly. According to estimates by the Department of Interior, over the next year, from 1 million barrels per day to 1.6 millions barrels per day may be lost. When combined with the natural erosion of the reserve base which is not being replaced by new discoveries, the effects of insufficient drilling and lost capacity could reduce America's domestic production to as little as 6 million barrels per day within three years, a drop of 31.8% from the 8.8 million barrels per day level at which production had been maintained. This could bring U.S. import demands up to as much as 60% of the total U.S. consumption by 1990. According to the Adminstration's "Energy Security Report," which was released in March of this year, overall U.S. oil imports rose from 5,067,000 barrels per day in 1985 to 6,061,000 barrels per day in 1986. This is a one year increase of 994,000 barrels per day, or nearly a 20% increase in imported petroleum products.

A drop of U.S. production to the 6 million barrels per day level would specifically raise the U.S. import requirement from the Persian Gulf. Presently, the majority of the world's shut-in oil capicity is centered in that area of the world. However, such an increased reliance on the Middle East would, as many Members of Congress are well aware, create a vulnerability which we believed had been eliminated by the drilling surges of the early 1980's.

There is a simple way to boost domestic oil production and reduce our dependence on imports: oil import fees. There is strong opposition to oil import fees in many regions of the country and from many different industries. This opposition rests on one principal criticism: the oil import fee imposes costs on our economy. This is true, but as with many other worthwhile policy objectives, there are costs involved. The questions should be: "What are the benefits?". "What are the costs?", and "Do the benefits outweigh the costs?"

Earlier in this session of the 100th Congress, I introduced the Energy Independence Act of 1987 (HR 2200). The goal of this Act is to impose a variable rate fee on imports of crude oil and petroleum products and use the revenues for deficit reduction and energy security programs. I should note, HR 2200 is the only oil import fee legislation before Congress which has a solid degree of bi-partisian support.

My Energy Independence Act of 1987, would accomplish the following:

*Establish a world floor price for oil of $25 per barrel through a variable rate fee with a $25 trigger price. The fee "turns off" when oil prices rise above $25 per barrel;

*Direct the Secretary of Energy to use 25% of the revenues from the import fee for the purchase of stripper well oil at a fixed price of $25 per barrel. Purchases would cease when prices rise above $25;

*Mandate that 75% of the revenues from the oil import fee be used for deficit reduction;

*Require that the purchased stripper well oil be stored in the Strategic Petroleum Reserve (SPR). At the same time, the fill rate of the SPR is raised to the maximum rate of 100,000 barrels per day and the size of the SPR is increased from 750 million barrels to 1 billion.

If the Energy Independence Act of 1987 were to become law today, the daily revenue from the import fee would be approximately $31.8 million. The import fee would generate roughly $12 billion on an annual basis. This bill splits the revenues, with 25% going to the purchase of stripper well oil and 75% going to deficit reduction. HR 2200 would provide approximately $7.95 million per day for purchase of stripper well oil for the SPR and $23.8 million per day for deficit reduction. This legislation would provide approxiamtely $7-9 billion annually for deficit reduction.

My legislation would have a number of benefits: It would lower America's dependence on foreign oil; It would strengthen the U.S. domestic oil and gas industry; and, it would use new revenues to balance the federal budget through deficit reduction. Other proposals, such as an increase in the excise tax on gasoline, would also raise new revenues. However, a gasoline tax increase would not create any new jobs or benefit domestic oil production.

There are other benefits to a broad based variable rate oil import fee. Our trade deficit would be much smaller with an oil import fee. If oil imports are reduced by 1 million barrels per day, assuming the cost of those imports would have been $19 per barrel, then almost $7 billion would be lopped off our annual trade deficit. As mentioned earlier, American jobs will be created. Some experts have placed the number as high as 400,000 jobs in the oil and gas exploration, production and service sectors. These jobs will boost our GNP, and flow into not only energy sectors of our economy, but also vital sectors such as machine tools, steel and transportation. Our national security will be greatly improved, because our economy will not be dangerously dependent on foreign oil sources.

A variable rate oil import fee, by setting a target price, would also bring some stability to oil markets. Lee Iaccoca, Chairman of Chrysler Corporation, has publically stated that his company can build cars designed for $10/barrel oil or $30/barrel oil, but not both. A $25/barrel target price will stabilize the world oil price very near to that point. Price stability would enhance long term planning for not only the oil industry, but all industry.

An oil import fee should be viewed as an insurance policy against an oil supply disruption. An acutarian could argue that the lower our dependence on oil imports, the lower will be the risk and economic impact of an oil supply disruption. Like any insurance policy, there is a premium that must be paid for the benefits of protection against the economic impacts of an oil supply disruption. In this instance, the insurance premium is paid in the form of slightly higher crude oil prices that will naturally result in higher prices for refined products. For every dollar per barrel the fee raises the price of imported oil, the price of gasoline could increase by between 2 to 4 cents per gallon.

Compare this cost of nickels and dimes per gallon to the cost we are paying today to keep the sea lanes of the Persian Gulf open. It has been estimated that our naval and air forces there, in dollars, cost us 40 billion a year. This is just the dollar cost, to say nothing of the cost of American lives already lost, and the potential for futher loss of life.

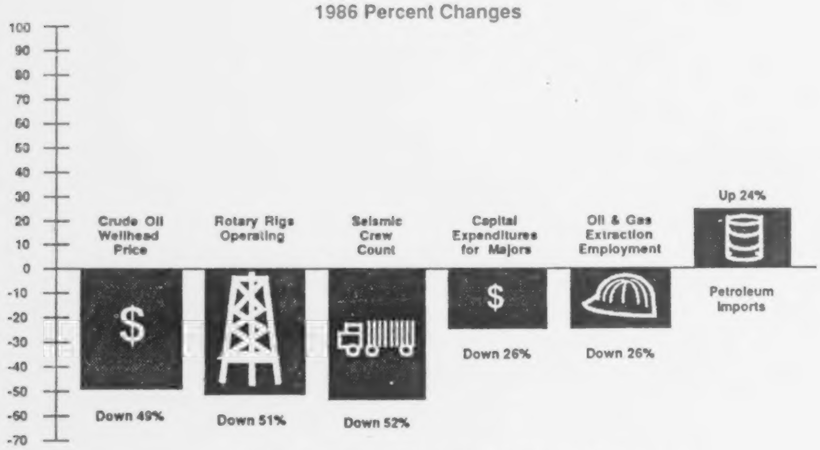
There is no guarantee that this huge expenditure of funds and resources will present another supply disruption. The OPEC countries have not hesitated to use crude oil as a polititical weapon against the West and the United States. Everyone is familiar with the 1973-74 oil embargo and the supply disruptions of 1979. However, it should be noted that there have been 15 oil supply disruptions since 1948, and all were imposed for political purposes. Early embargoes were ineffective because we were not dependent on imported oil for domestic consumption. The 1973 and 1979 disruptions hurt the U.S. because we had become dependent on imported oil. The General Accounting Office estimated that the 1973 oil embargo lowered the Gross National Product (GNP) by $300 billion. Moreover, the oil supply disruptions in the wake of the 1979 Iranian Revolution lowered the GNP by $500 billion.

Do you realize that our dependence on oil imports is heavier now than it was in 1973? The economic impact of an oil supply disruptions now, even with a large Strategic Petroleum Reserve, would be substantial. According to a report concluded by the Office of Technology Assessment, a serious disruption could cause a 10% decline in GNP, a 6% rise in unemployment, and a 20% increase in inflation.

Energy independence is not an issue which only just affects one region or one sector of the United States. It is a national issue which affects us all. The average American tends to think in terms of oil "gluts" and cheap gasoline. We tend to focus on the visable short-term benefits of cheaper oil. We are complacent about increasing oil imports. This attitude is similar to that which existed before the 1973 embargo. Since that year, the U.S. has paid out more than one-half trillion dollars for imported oil, two-thirds of which went to OPEC countries. When the full cost of all the resulting inflation, unemployment and slower growth are taken into account, complacency in the early 1970's cost the U.S. as much as $2 trillion. If this complacency continues through the late 1980's, the costs could be even higher.

If you do not believe our country will ever suffer another oil supply disruption, similar to the oil supply disruptions imposed on us in the past, then do not consider supporting an oil import fee. But if you believe it is possible that we may someday be again subjected to a serious oil supply disruption, then consider the old saying: "You can pay me now, or pay me later." In my opinion, the payment "now" will be much less than what we will have to pay "later" when our oil supplies are disrupted and our economy is crippled. I prefer to pay a reasonable insurance premium now, in the form of a variable rate import fee, and avoid possible future economic disruptions.

1986 Percent Changes



Source: Visual Concept, IPAA; Numbers, Department of Energy

Mr. ANDREWS. Thank you very much, Joe. We appreciate your testimony.

Mr. Duncan.

Mr. DUNCAN. Thank you, Mr. Chairman. I have nothing further.

Mr. ANDREWS. Congressman James Traficant of Ohio.

STATEMENT OF HON. JAMES A. TRAFICANT, JR., A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OHIO

Mr. TRAFICANT. Mr. Chairman, now I know why Ways and Means is such a powerful committee. I was instructed an hour and a half ago to get over here in about 5 minutes.

I am glad to be here and I am glad the bell has not rung yet and I hope I can get it through so you do not have to come back.

I would ask my full statement be submitted for the record and I am certainly not going to read it. I would like to touch on it.

I have a bill in, H.R. 606, the Foreign Subsidiary Taxation Equity Act. Basically, this is what it does. Two years ago, AT&T closed down its plant in Shreveport, LA, where they produce residential telephones. They moved to Singapore. They terminated the 1,250 employees in Shreveport. They spent $30 million, invested $30 million in Singapore, hired 1,500 foreign workers and now they make the same telephones in Singapore.

Now be advised that we cannot penetrate a lot of markets with our telecommunications industry. Their main target for sales of those residential telephones is the United States of America. They will ship it back to us.

Under the existing law, if they take the profits and reinvest them in that plant, or hire more people, they will not even pay taxes.

H.R. 606 is not a new idea, to a degree. In 1962, President Kennedy sought to completely eliminate the deferral principle. In 1978, President Carter also recommended that deferral be repealed.

Last year, subpart F provisions were expanded to include some passive investments, but they did not go far enough. Specifically, my legislation would work as follows: No. 1, it would include a new category of foreign based income, under subpart F to complement the existing categories of foreign personal holding company income, sales, services, shipping and oil. That sixth and very important catagory would be manufacturing related income.

In addition to that, it would list other variables that show that this accommodates about $100 million to $250 million a year in lost revenue. But more importantly, it is an incentive for people to move overseas and, in fact, the United States is absolutely hurt by losing the manufacturing jobs and thus losing the income from it.

In addition to that, I would like to also state my concern briefly about the current practice for allowing full tax credit on payment of foreign taxes by foreign based corporations. I believe the committee should repeal the current foreign tax credit and replace it with a foreign tax deduction.

In other words, instead of giving them a dollar for dollar credit against their taxes, we would give them an overall deduction against their income. I believe the proposals I have brought forward would do two things. First, they would eliminate tax incentives for American corporations who move overseas, take our technology with them, hire foreigners, and then ship their products back to the United States.

And second, finally, let us take away that credit. Why be so generous? Let us offer it in the form of a deduction that would, in the long run, save a lot of American jobs and raise revenue. That is what we are here about today.

So when I hear the gentleman from the Southwest complaining about oil, I am very concerned about that oil. When they talk about that oil derrick lying down, rusting, the steel mills have rusted and fallen apart. America's response has been tear them down.

I am saying the Foreign Base Income Code, subpart F, section 954 should be expanded to include foreign based manufacturing related income and that, also, we should change that foreign tax credit to a deduction.

With that, I conclude my testimony.

[The statement of Mr. Traficant follows:]

TESTIMONY OF
CONGRESSMAN J. A. TRAFICANT, JR.
BEFORE THE HOUSE COMMITTEE ON WAYS AND MEANS
JULY 15, 1987

Mr. Chairman:

I am both pleased and honored to come before the Ways and Means Committee today to request that legislation which I introduced, H.R. 606, "The Foreign Subsidiary Taxation Equity Act," be favorably considered as a viable option for raising revenue. I believe my proposal should be considered as a top priority. Not only will this legislation raise much needed tax revenues, but it will also discourage U.S. manufacturing firms from establishing subsidiary plants abroad-- therefore keeping American technology and jobs here, at home, where they belong.

Last year Congress worked hard to reform our tax system. We reformed almost every tax law to create more just and fair taxation. Congress eliminated unfair tax deductions and we eliminated many loopholes. Yet, despite the enactment of this landmark measure, our tax code still allows American based corporations to avoid payment of taxes to the United States on income earned by their subsidiaries in foreign countries. In addition, the tax code continues to allow these firms to develop technology and manufacturing processes here in the U.S. and then set up manufacturing plants abroad, taking with them American jobs and American technology. I don't understand why we allow these companies to be seduced by foreign countries, especially at a time when employing Americans and investing in U.S. manufacturing is so vital.

The culprit is the deferral principle, a loophole that must be plugged. Under the present laws, U.S. corporations can establish subsidiary corporations abroad and avoid paying U.S. taxes on profits from these manufacturing plants until a much later date. By incorporating a subsidiary plant in a foreign country, a parent firm in the U.S. can postpone tax payments on income from that plant until the money is brought back to the stockholders of the parent firm in the U.S. This, of course, provides a huge tax incentive because, as long as the tax liability is deferred, the firm is able to reinvest the funds and earn returns on them.

Everybody wants to earn higher returns and make greater profits, but at what expense. It´s simply not right when the federal government continues to lose millions of dollars of income and American workers continue to lose thousands of jobs. We have to plug this loophole of deferral now.

My idea is not a new one. In 1962 President Kennedy sought to completely eliminate the deferral principle. Congress instead adopted the tax code´s Sub-Part F provisions which are a very limited repeal of deferral for only a relatively few kinds of investment. In 1978 Carter also recommended repeal of deferral. And consideration of during the 1986 tax reform legislation, Sub-Part F provisions were expanded to include passive investments abroad. However, these provisions don´t go far enough. It´s time to expand Sub-Part F of the tax codes to include much stronger and more substantial restrictions so that we can once and for all put a stop to this unfair abuse of tax havens.

H.R. 606 does this by substantially restricting deferral by taxing not only passive investment income but also manufacturing income on a current basis. I have defined these two additional types of manufacturing plants that must be included in Sub-Part F as "tax holiday plants" and "runaway plants."

The tax holiday plant is a manufacturing plant that is receiving special tax benefits from the foreign country for the purpose of providing an incentive to establish, maintain, and/or expand the plant. The runaway plant is a manufacturing plant that is located in a foreign country whose tax rate is substantially lower than that of the United States. This plant also must ship more than 25% of its goods back to the U.S. The purpose of these definitions is to tax subsidiary corporations that are primarily tax motivated, plants that would otherwise be located in the United States, paying U.S. taxes and providing Americans with jobs.

This loophole in the U.S. tax law encourages foreign countries to give special tax breaks to U.S. companies to entice them to establish and expand plants in their country. In effect the United States government is indirectly subsidizing corporations that build their manufacturing plants in foreign countries. We are encouraging unemployment and the further decline in our capital base. This is wrong, especially at a time when areas in the United States are suffering from severe economic depressions. It especially harms areas like the 17th district which rely heavily on manufacturing jobs as the chief source of employment.

One important point to note is that eliminating the deferral loophole would raise hundreds of millions of dollars in federal revenues. Presently, it estimated that over $100 million dollars per year in tax revenues are deferred because of this loophole. Between 1988 and 1992 we could raise at the very least over $400 million dollars without further burdening the American worker. Please note that these revenue estimate are very low, and the likely benefits will be much higher. These revenues are sorely needed and the answer is simple, stop deferring taxes on profits of the subsidiaries who unfairly abuse the tax system.

At this point, I want to reemphasize the importance of this legislation in both raising necessary tax revenues and keeping the manufacturing jobs we have in America by closing these unfair and long-abused loopholes. We can do this, simply, by adding to Sub-Part F of the tax code a provision to include manufacturing related income from foreign based companies. We must tax these companies on a current basis so they can no longer indefinitely avoid payment of taxes.

One final note. I would like to state my concern about the current practice of allowing for full tax credit on payment of foreign taxes by American based corporations. Right now, I am in the process of drafting legislation that should replace the foreign tax credit with a deduction. By eliminating credit of foreign taxes against U.S. taxes and instead allowing only a deduction from taxable income we will begin collecting revenues that rightfully belong to the United States government, not to other foreign governments. Again, I believe it's high time we worked to maximize the benefit of our own economy. By replacing a foreign tax credit with a foreign tax deduction and by eliminating the deferral principle, we will earn revenues both in tax revenues and in creating an incentive to return investment funds back to the United States.

As Congress examines ways to make America competitive in the world marketplace, it's vital that policies are implemented that work for the American Worker. Lets remove glaring loopholes in the the tax code that unfairly take away our "home field" advantage.

This concludes my formal testimony. I appreciate your consideration of my legislation. I'll be happy to answer any questions you may have.

SUMMARY OF H.R. 606, THE FOREIGN SUBSIDIARY TAXATION EQUITY ACT

I. Current Law

A. I.R.C. Sec 951 provides that U.S. shareholders must include in their income their pro rata share of "subpart F income" from any "controlled foreign corporation" in which they have 10% or more voting control. I.R.C. Sec 951 and 951(b).

1. A "controlled foreign corporation" is defined as a corporation which is more than 50% owned by U.S. shareholders. I.R.C. Sec 957(a).

2. "Subpart F income" includes five different categories of what is termed "foreign base company income." I.R.C. Sec 952 shareholders.

   a. Foreign personal holding company income.
   b. Foreign base company sales income: generally, where the subsidiary is being used as a conduit for selling the products of the parent or buying products for parent.
   c. Foreign base company services income: technical and other services performed in the foreign country. Specifically excludes services related to the manufacture of goods within the foreign country.
   d. Foreign base shipping income.
   e. Foreign base company oil related income: other than income derived in connection with extraction of oil or gas within the foreign country.

II. Changes Proposed by H.R. 606

A. Amend I.R.C. Sec 954 to include a new category of foreign base company income: "Foreign Base Company Manufacturing Related Income." This is defined two ways:

1. "Tax holiday plant": manufacturing plant receiving special tax benefits from the foreign country for the purpose of providing an incentive to establish, maintain or expand the plant.

2. "Runaway plant": plant manufacturing personal property, 25% or more of which is consumed in the U.S. where the plant is taxed at an effective rate of less than 80% of the effective rate would be in the U.S.

Note: The purpose of these definitions is to tax subsidiaries that are tax motivated, plants that would otherwise be located in the U.S., paying U.S. taxes and providing U.S. workers with jobs.

Mr. **Andrews**. Thank you, Mr. Traficant.

Mr. Duncan.

Mr. **Duncan**. I have no questions. Thank you.

Mr. **Andrews**. Congressman Jim Moody.

STATEMENT OF HON. JIM MOODY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF WISCONSIN

Mr. **Moody**. Thank you, Mr. Chairman. It is a pleasure to be on this side of the table. This is my first time.

I am here today to strongly support two alternative forms of energy taxation, either independently or possibly in some combination of the two. I support an oil import tax and I support a gasoline tax.

The major reason I do so is not that they are the first on my list, if I could have my druthers. The first on my list would be such things as loophole closures, base broadening, perhaps a three percent threshold on indexing, the sort of thing that Marty Felstein wrote about several days ago in the paper, some of the President's own taxes, not asset sales but some of the ones he has suggested.

We should look at capital gains at death, as long as there was some relief for family farm and small family businesses. And a series of compliance measures such as those suggested by Congressman Dorgan.

But we may not be able to get many, if any, of those items. More than anything, we have to reduce the deficit and we have to meet our $19.3 billion assignment. I think the international financial markets are poised to find out whether or not Congress is going to meet its obligations, whether or not the deficit is really going to come down $36 plus billion, or is it going to be business as usual with a few anemic cuts, six here and two there, a few here and then some assets sales, such as the REA. Are we going to make a real cut in this deficit? We cannot unless revenues are invoked.

So for that reason, I am prepared to support energy taxes.

There are some very strong merit arguments for energy taxes on their own, but I turn to them now primarily because of what I consider the desperate situation with the deficit.

If we do not act to close the deficit, in my judgment, we will be paying higher interest costs sooner or later, far in excess of any taxes that we could possibly be paying through any of the measures described herein.

The financial markets are unforgiving and if they are convinced the Congress is not going to close the deficit, interest rates will be higher. If interest rates are 100 basis points higher, even only 100 basis points higher, it will swamp any tax effects in terms of its impact on employment and its impact on the burdens that ordinary people will pay in mortgages, consumer credit, automobile credit and everything else.

The taxes we are talking about will pale in comparison to the costs we will eventually pay through the interest rate mechanism and through the foreign trade deficit mechanism.

Let me now turn to the two kinds of savings that I am proposing. They both have in common the fact that they promote conservation, which I submit, is a national interest given the need for international energy independence, given the fact that we are now approaching—in fact, we are beyond the point of energy dependence that we were at when the OPEC shock hit in the early 1970s.

So for international independence purposes, for military security purposes, and for environmental reasons, conservation is still a strong public policy which we should pursue and both oil import fee and gasoline taxes do buttress that.

No. 2, of the things they have in common, they are both relatively painless. In the case of the gasoline tax, I am proposing a 9 cents per gallon increase. Gasoline has risen a bit lately but generally, in real terms net of inflation, Mr. Chairman, gasoline is cheaper today than it has been for most periods of our history.

In 1981, gasoline was selling on a weighted average of $1.40 per gallon. Today gasoline is just about at $1 per gallon on a weighted average basis. But $1.40 in 1981 translates into $1.70 in 1987. We are now looking, therefore, at gasoline at $1 which is 70 cents cheaper per gallon in constant value terms than it was in 1981.

To make up one small part of that 70 cent windfall through a 9 cents per gallon tax is to take a very small part back indeed. It is an ideal time for us to turn to gasoline or imported fuel as a base for the tax.

The third thing I would point out, common to both of them, is that the regressivity argument is generally overstated and some witnesses that have appeared at this table today have been talking about the excessive claims about regressivity and I will not repeat their language.

But I will point out that regressivity can, in both cases, be ameliorated by other things that we can do and I will address that as I go through it.

Now let me turn to those two taxes. The first one I would like to talk about is the oil import fee and the variety I would propose is the one that others here have proposed today; namely, a variable oil import fee, a sort of gap tax that would make up the difference between the actual international market price and the $24 per barrel level. So at $18 we would be picking up $6 per barrel.

That would give us stability. It would give us long term, the ability to plan on our own energy investments in the oil producing States of this Nation. Investors could plan. They would not be on a roller coaster with all of the uncertainty that has plagued them.

An additional important element of this tax is that foreigners would pay a great deal of the cost. Let us say it was a $6 per barrel tax. The cost to the American consumer would not be entirely borne by the American consumer. In fact, a great deal of it would be shifted back to the overseas producer.

Because their costs are considerably lower than the $18, frequently in the $3, $4, $5 or $6 range, Saudi Arabian producers, for example would not be induced to reduce production merely because of this tax. But the increased price would, to some extent, dampen total demand. That would force a shifting of the burden back onto the overseas producer.

One estimate is that approximately 37 percent of the cost would be borne by the overseas producer, which is a significant benefit for any tax, when you can have it borne by someone else.

As I mentioned, another primary benefit of this tax is what it would do for the domestic oil industry. In the long term, we are not well served by a cheap oil policy that leaves our domestic oil industry in shambles, which it is today. In the long run, we will end up paying lower priced oil, I suspect, then if we become totally incapable of producing our own oil as a result of the depressed economic conditions in that market.

Let me now turn to the regressivity argument that is often raised against this kind of a proposal and it applies basically to both cases. About one-half of the income of lower income individuals consists of transfer payments which are now indexed to inflation. So your typical low income person actually has about half of his income in the form of transfers which are, in each case, themselves indexed.

Declines in real income, as a result of oil import fee or a gasoline tax, would at least be partially offset by these adjustments. That is no small thing because energy costs make up approximately one-fourth typically of the changes in CPI.

No. 2, the Congressional Budget Office recently estimated the distributional effects of a simulated $1 billion increase in a variety of excise taxes on all income groups. The study found that for the lowest income class, the tax increase on any of the taxes considered, including gasoline and others, would be between 0.2 and 0.3 percent of income, namely two one-hundreths and three one-hundreths of income and less than 0.1 percent of total expenditures.

So the regressivity argument, as I mentioned, is generally greatly overstated.

There also is a way of ameliorating the regressivity. The most efficient way, in my judgment, is through a sweetening of the earned income tax credit, and that goes to the argument that poor people have to drive to work and if you raise the price of gasoline, you are talking about hurting poor people trying to get to work when, in fact, the earned income tax credit with a relatively simple adjustment, could be made to cover most or all of the extra amount of cost and yet it would be highly targeted to the affected population.

Now let me turn to the gasoline tax in a little more detail. As I mentioned, I would suggest a 9 cents a gallon tax. That raises about $7.2 billion a year, slightly less than $1 billion per penny. My own proposal would be to exempt diesel fuel on the grounds that this would hurt our competitiveness as a nation and our export earnings would suffer and therefore diesel fuel, which predominantly moves commodities, not people, would be exempted.

The proceeds would be earmarked to a special deficit reduction trust fund and could not be used for additional spending. My own personal opinion is that also it would be helpful to sunset the law and make it quite clear that along with the earmarking and escrowing, it be specifically aimed at deficit reduction.

This kind of tax is easily collectable. The administrative mechanism is already in place. It would not be a user fee, it would not pretend to be a user fee and many of the criticisms I think we heard from Chairman Glenn Anderson earlier today would not actually be quite so severe if you recognize it is not a user fee. It is simply using a very broad base as a taxation base for collecting an excise tax.

As I also said, it would be a fairly painless way to raise the money. Assuming 30 miles per gallon mileage on your car, if you drove 10 miles, that is only 3 cents. Three cents per day. If you commute 10 miles a day, that is 3 cents. If you commute 100 miles a day, it is only 30 cents. That is not very much money per year; 30 cents a day at 10 miles is only $7 per year, if you consider 230-some days.

One hundred miles, as I said, it would correspondingly be $70 a year. Shucks, a tiny change in interest rates as a result of our failure to fix the deficit will cost far more to the average consumer and the average worker in this country than $70 a year. Let us say the average worker has a $40,000 debt out there in his mortgage, if he has a variable rate mortgage. He has consumer debt. He has a car loan. He may have a student loan, he may have other kinds of credit.

One hundred basis points, a 1 percent change in a $40,000 line of credit for mortgage or whatever is a $400 per year increased cost to this consumer. So Mr. Chairman, you are talking about $70, on the one hand, for a real deficit reduction versus something like perhaps $400 at a relatively conservatively estimate if we fail to bring the deficit down.

Those are my basic comments. I would be happy to entertain questions.

[The statement of Mr. Moody follows:]

STATEMENT OF THE Hon. JIM MOODY ON
REVENUE OPTIONS FOR DEFICIT REDUCTION PURPOSES
BEFORE THE
COMMITTEE ON WAYS AND MEANS

Wednesday, July 15, 1987

contact: Richard Chriss
202 225-3571

Thank you, Mr. Chairman, for this opportunity to discuss my proposals for meeting our deficit reduction goals for FY 1988.

The deficit continues to pose both an economic and a political challenge. For the Democratic members of this Committee, these discussions pose a special responsibility: to sustain the credibility of the budget blueprint we adopted earlier this summer.

The economic challenge requires us to find fair and efficient revenue options to close the FY 1988 deficit gap. The political dimension is just as challenging: to preserve the hard won agreement of tax reform that will eventually consolidate 14 tax rates into just two.

We forged a working consensus on tax reform by doing away with the many special preferences that crept into our tax system over the years. We must preserve both the consensus and the reform.

This morning I would like to advance a general proposition and a few specifics. My general proposition is that if we have the courage and the foresight, today's deficit reduction choices will help us reclaim our global economic leadership.

I would like to focus for a moment on the deficit crisis, and explain why we must approve reasonable, fair revenue increases. Here. Today.

The unprecedented high budget deficit has profoundly affected the role that the United States could play in the international economy. Between 1980 and 1985, the need to finance an annual budget deficit of $200 billion or more caused the American savings rate to drop from about 17 percent to 12 percent. The budget deficit also meant a serious decline in capital accumulation, absorbing more than half of all national savings. In the six year period of 1979 to 1985, we lost about $1.6 trillion in private capital accumulation, depressing the GNP by about $160 billion every year. The consequences of this decreased capital accumulation were lower productivity, accelerated deterioration of our industrial base and a lower standard of living for everyone.

That is why we are here today, Mr. Chairman. Now I would like to suggest some specific options that I believe will put us on the right track.

First, we should levy new excise taxes on imported crude oil, gasoline and other consumer items such as tobacco products.

Our heightened vulnerability to foreign oil producers directly contributed to our current economic predicament. Let's go back for a moment to 1973. After the first oil price shock of that year, the consumer price index nearly doubled. Short-term interest rates skyrocketed.

After the second oil price shock in 1979-80, when oil prices jumped from $18.60 per barrel to over $30 per barrel, the consumer price index hit the highest peak of this decade. U.S. crude oil refining capacity suffered a near-crippling blow: In 1979, 301 U.S. refineries processed nearly 17.6 million barrels of crude oil for domestic use. Last year, 192 refineries processed 14.6 million barrels.

Adopting an oil import fee equal to the excess of $24 over the weighted average price of imported crude on all imported crude and refined petroleum products would raise about $12.1 billion of the $19.3 billion in new revenues we need to meet deficit reduction targets.

We would realize other important benefits by imposing this fee.

First, we would shift a major part of the burden of the tax overseas to foreign producers in the form of lower world oil prices. The U.S. consumes about one third of oil produced outside the Communist Bloc. Because the U.S. is such a large consumer of oil, policies that reduce demand for imported oil would lower world oil prices. The Congressional Budget Office tells us that foreign producers would absorb about 37 percent of a $5 per barrel import tariff. This would improve our terms of trade, since lower world oil prices would also reduce the Free World's oil bill. As lower world oil prices are translated into lower world inflation rates, foreign central banks would be induced to lower their interest rates, thus stimulating higher levels of economic growth. An interest rate decline of just one percentage point would yield economic benefits for Mexico in the amount of about $900 million.

Second, we would encourage new capital investment in our floundering domestic oil industry. This is not just an economic issue, it is a vital national security concern. Capital spending by the U.S. oil and gas industry peaked in 1981 at $82.9 billion. That year there were roughly 4000 drilling rigs operating in the United States. Last year, there were only 1000 rigs drilling oil in the United States, a decline of nearly 75% from 1981.

Perhaps most importantly,though, we would gain much needed relief from the volatile course of hostilities in the Middle East and a measure of protection from politically motivated price increases.

A second option we should give some serious thought is a 9 cent per gallon excise tax on gasoline and gaschol. I recently introduced legislation (HR 2015) that would assess such a tax. Under my proposal, diesel fuel would be exempt from the levy, which would yield about $7.2 billion per year. The proceeds from this tax would be deposited in a special Deficit Reduction Trust Fund. These revenues could not be used to finance additional spending.

I would like to point out that this new tax would not alter the current tax structure of the Highway Trust Fund in any way. Funds collected under this tax would not be intermingled with the current levies collected for improving our highway infrastructure.

This tax would still leave gasoline prices far lower than they have been through most of this decade. Moreover, such a small change in such a widely used commodity would be a fairly painless way to raise a lot of money-almost 40% of the required $19 billion.

Nor would this be a highly regressive tax. For example, assuming automobile mileage of 30 miles per gallon, the net cost is about three-tenths of one cent per mile. Thus, at a commuting distance of ten miles per day, the net cost of the tax is about $7 per year. At a commuting distance of 100 miles per day, the net cost would rise to only $70 per year.

That is cheap compared with the effects of increases in interest costs as a result of not reaching the deficit target. Each one percent increase would cost an additional $10 per $1000 debt. A moderate income family with a total of $40,000 in mortgage and consumer debts would thus pay about $400 more in increased interest costs per year.

I would like to say an additional word or two about the problem of regressivity. Certainly consumption taxes have a more adverse effect on the poor than those with higher incomes. But I would like to point out three reasons why some excise taxes are not as regressive as commonly believed.

First, about one-half of the income of lower-income individuals consists of transfer payments which are now indexed to inflation. Declines in real income as a result of an oil import fee would be at least partially offset by these adjustments.

Second, The Congressional Budget Office recently estimated the distributional effects of a simulated $1 billion increase in excise taxes on all income groups. The study found that for the lowest income class, the tax increase from any of the excise taxes considered- including gasoline and tobacco products- would be between 0.2 and 0.3 percent of income, and less than 0.1 percent of total expenditures.

Third, expenditures for items such as tobacco vary a great deal within each income group. That is, not all families within particular income groups purchase certain items. Because of the discretionary nature of many of these expenditures, the amount of dollars spent on items covered by excise taxes varies as much within income groups as among income groups. This dispersion is greatest among low-income families. For example, about 50 percent of low-income families purchase no tobacco. So it is not enough to dismiss excise taxes simply by claiming that they are regressive, because an analysis of consumption patterns shows that there is a wide dispersion of discretionary purchases within income groups.

Where regressivity is still apparent, it is possible to offset some of the effect of an excise levy on moderate income persons by simultaneously improving tax benefits carefully targeted to the working poor. The Earned Income Tax Credit is an extremely efficient way of doing this.

Currently, the EITC is 14% of the first $5,714 in earned income, for a maximum credit of $800. A small increase in either the percentage credit and/or the $800 cap would help offset the impact of the gasoline tax on the working poor, while ensuring that the tax still raises a substantial portion of the revenue required for deficit reduction purposes.

Finally, Mr. Chairman, I would like to propose a last category of progressive revenue raising options that would close existing loopholes and contribute to tax reform.

I suggest that we end the growth of so-called master limited partnerships. These publically traded corporations are organized solely for the purpose of avoiding corporate income tax. This device threatens to undermine the recently redesigned corporate income tax.

We should end excessive tax depreciation write-offs under the Accelerated Cost Recovery System. We could accomplish this by substituting a 125 percent declining balance where 150 percent is now used, and 150 percent where double declining balance is now used. The Joint Tax Committee tells us that these overly generous write-offs will cost us $227 million over the next five years.

We could repeal the stepped-up basis rule, so that an income tax could be imposed on the net appreciation in property passing from a decedent at his death. Relatively small estates, and property passing to a surviving spouse would be exempted.

The Committee should consider a securities transfer tax. A high concentration of securities ownership among higher income individuals would make this a progressive levy.

We should consider repealing the tax deferral on income from "runaway plants", U.S. corporations that manufacture goods overseas for consumption in the United States. Our tax policy should not encourage U.S. companies to manufacture their goods in low-tax foreign environments.

Finally, we should increase funding for the Internal Revenue Service to increase compliance with the income tax laws. Increasing the income tax compliance rate by just several percentage points would yield tens of millions of dollars in uncollected revenue. Fairness is the cornerstone of our tax system. Leaving large amounts unsought and uncollected is unfair to the vast majority who comply with our laws.

In conclusion, we cannot continue to run an economy that depends on the constant pyramiding of massive debt and the siphoning of capital from the rest of the world. Action on these suggestions will send a clear message throughout the economy that we are truly serious about bringing the deficit under control.

Thank you.

Mr. ANDREWS. Thank you very much, Jim.

Congressman Duncan.

Mr. DUNCAN. I would like to thank you, also, Jim. I have mentioned it before. I appreciate the interest that you have taken in the committee since you have been on here. You have been very diligent in familiarizing yourself with the various subjects. You have given us a lot of things to talk about and we do appreciate the input you have given us.

Mr. MOODY. Thank you.

Mr. ANDREWS. Thank you for your testimony.

The committee stands adjourned.

[Whereupon, at 3:14 p.m., the hearing was adjourned.]

[Submissions for the record follow:]

SUBMISSIONS FOR THE RECORD

Due to the numerous submissions received for the record on the subject of revenue increase options, an attempt has been made to categorize the material by specific subjects. Note that a category of "General" has been created to accommodate those statements and letters that express views on revenues, excise taxes, tax exempt organizations, etc., although in some cases they may go into detail on one or more specific subjects.

The subject categories are:

General

Revenue Areas Addressed by the President's 1988 Budget Proposals:

- State and Local Medicare Payroll Tax
- Administration Excise Tax Provisions
- PBGC Premiums

Other Possible Revenue Options:

- Alcoholic Beverage Excise Taxes
- Tobacco Products Excise Taxes
- Telephone Excise Taxes
- Luxury Excise Taxes:
  - Boats
  - Boats and Ineligibility of Boats and Mobile Homes as Second Residences
  - General Aviation Aircraft
  - General Aviation Aircraft and Aviation Fuel
  - Jewelry
  - General
- Firearms Excise Taxes
- Pollution Excise Taxes
- Energy Consumption Taxes
- Motor Fuels Excise Taxes
- Trust Fund Excise Taxes
- FUTA Provisions
- Excise Taxes - General

Securities Transfer Excise Tax

Income Tax Provisions:

- Individual and Corporate Tax Rates and Surtaxes
- Interest Deduction on Home Equity Loans
- Employee Benefits
- Employee Stock Ownership Plans (ESOPs)
- Accounting Provisions:
  - Advertising Deductibility Limit
  - General
- Farming Provisions
- Financial Institutions
- Corporate Provisions
- Partnership Provisions
- Depreciation Provisions
- Foreign Tax Provisions
- Insurance and Annuities
- Alternative Minimum Tax
- Compliance

Gift, Estate, and Generation-Skipping Taxes

Tax-Exempt Organizations:

- UBIT on Certain Trade Association Income
- Excise Tax on Net Investment Income
- General

Alternative Proposals

The reader should not rely on these categorizations to be all-inclusive of communications received on a particular subject.

GENERAL

STATEMENT

FOR THE RECORD

BY

THE AMERICAN ASSOCIATION OF RETIRED PERSONS

The American Association of Retired Persons (AARP), represents the interests of 26 million persons aged 50 and over. AARP applauds Congress for adopting the FY 1988 budget resolution and offers the following comments on revenue raising options before Congress to reduce the federal deficit.

In the face of unsustainable federal deficits, the Association has maintained that any responsible deficit reduction strategy should include the restoring of the federal revenue base to a fiscally prudent level, and this year is no exception. AARP believes that any overall deficit reduction program Congress adopts -- one in which revenue is an essential but not the sole component -- must recognize the past sacrifices made by various groups as well as equitably distribute the pain of any further deficit reduction efforts.

Finding the revenue sources to meet the $19.3 revenue target in the FY 88 budget resolution represents a formidable challenge, but the revenue must be raised unless we are prepared to live with the consequences of unacceptably high deficits. The Association believes that any revenue package Congress adopts must be

- equitable and perceived as fair;
- conducive to economic growth; and
- easy to administer.

I. RAISING REVENUE THROUGH INCREASED COMPLIANCE

The Association believes that increasing compliance is a priority method of raising revenue; one to be fully explored before turning to other alternatives that raise the taxpayers' burden. Approximately $100 billion in revenue still escapes taxation annually through noncompliance resulting from the underreporting of income, the overstatement of deductible expenses, the failure to file, or the failure to pay tax liabilities even when reported correctly. Improving compliance requires minimal federal outlays; few, if any, changes in current law; and it is especially appealing to the bulk of honest taxpayers. Given the enormity of uncollected taxes and the need to reduce the deficit, the Association recommends that the committee address the noncompliance gap as the first step in any deficit reduction strategy.

AARP believes that H. Con. Res. 138, which embodies the recommendations of Representative Dorgan's task force on noncompliance, should be considered seriously by the committee.

Congress previously enacted legislation in 1982, 1984, and 1986 to combat noncompliance. These laws enhanced IRS' arsenal of weapons against noncompliance, including improved information reporting and stiffer penalties.

While these tools lessened the noncompliance rate somewhat, they only attacked one aspect of a multifaceted noncompliance picture. As a result, the noncompliance rate did not shift dramatically downward. To effectively reduce taxpayer noncompliance still further, the percentage of returns currently audited must rise. The reduced likelihood of an audit emboldens those who disregard the law; and, those who do not comply with the law because they do not understand it escape audit detection as well.

In 1976, 2.5 percent of all taxpayers filing a return were audited. But, by 1986, audit coverage declined to 1.1 percent. From 1980 to 1985, the IRS reduced its staff in response to budget cuts. As a result, the compliance rate dropped from 86.5 percent in 1980 to 81.5 percent in 1985. An understaffed IRS simply could not keep pace with the workload or the ever-increasing complexity of the tax code.

Increasing audit coverage brings in additional revenue in two ways: by errors discovered in the audit process and by increased compliance attributable to taxpayer concern about a possible audit. The return on each dollar invested in audits is estimated at $9 or $10. (Some suggest a figure as high as $20 for each dollar invested.)

AARP also believes the President's budget proposal to increase IRS examination and enforcement staffs should be considered. They represent an excellent beginning for a larger and more extensive campaign against noncompliance. We also urge the committee to move toward reinstating an audit rate of 2.5 percent.

The Association recognizes that such increased enforcement has its costs. These include additional personnel and equipment, the possible diversion of some personnel from other productive activities, and the inconveniencing of taxpayers who comply with existing law, but who may have to spend more time justifying their returns. Furthermore, some taxpayers view additional enforcement as harassment or an invasion of privacy. Nonetheless, the revenue generated justifies the increased audit rate.

Increasing the audit arm and enlarging the battery of enforcement weapons is not sufficient, however. Assisting honest taxpayers is also important in improving compliance. It represents a logical investment with beneficial long term dividends.

The IRS needs to improve its accessibility and also consistently provide taxpayers with accurate and understandable information. A recent General Accounting Office report points out that about 40 percent of calls to IRS information service lines were not answered on the first attempt. More significantly, 15 percent of the callers received correct but incomplete answers, and 22 percent of the time the responses were incorrect.

Taxpayers tend to lose confidence in our tax system if they cannot get a timely or accurate reply to a question about tax law from the very agency responsible for enforcing that law. AARP's presidential award winning Tax Aide Program for the Elderly illustrates clearly the benefits of providing taxpayers with information and assistance in preparing tax returns.

One final point on noncompliance relates to the extensive tax code revisions of the Tax Reform Act of 1986

(TRA). Given the extent of these changes, IRS must quickly develop a comprehensive plan for educating the public about the new law. If this is not done in a timely manner, some taxpayers will face significant 1987 tax preparation problems, and, even worse, unforeseen revenue could be lost. (Some taxpayers may even be hard pressed financially to meet an unanticipated tax bill.)

II. BROADENING THE TAX BASE

The Association supported the Tax Reform Act of 1986 because on balance it benefits the majority of taxpayers and promotes greater equity. However, passage of the Act has restricted the potential use of the tax code for further deficit reduction efforts. Now, fewer preferences and "loopholes" remain as candidates for elimination. Moreover, reduced rates devalue the intact preferences. Additionally, some in Congress believe that further tax code revisions should be avoided until the ramifications of the TRA can be evaluated.

AARP has consistently supported efforts to broaden the tax base to eliminate or restrain tax subsidies of more limited value. The Association urges the committee to re-examine the code with an eye towards further refining existing preferences after TRA. Potential changes in corporate tax provisions include the current tax treatment of advertising expenses and restricting the tax advantages of limited partnerships. On the individual side, Congress may want to tighten up the law on home equity loans so as to eliminate perceived inequalities as well as to protect persons against unscrupulous lenders taking advantage of this provision.

III. EXCISE TAXES

A lively debate has emerged regarding increased excise taxes. Many people object to them as a major revenue raiser because of their regressive nature. While excise taxes generally tend to affect low income persons more than the rest of the population, the consumption of cigarettes, beer and wine varies within income classes. Thus, the increase will hit heavy consumers harder than moderate users, and non-consumers will be spared entirely. Also, the so-called "sin taxes" are essentially discretionary purchases, and taxpayers can reduce consumption to avoid a heavier financial burden.

Historically, the United States has relied on excise taxes as a significant revenue source. During the 1950's excise taxes raised about 14 percent of all federal revenues. After the enactment the Excise Tax Reduction Act of 1965, revenue from excise taxes began declining. By 1984 the revenue raised amounted to only 5.6 percent of all federal receipts. Not only did Congress eliminate many federal excise taxes over the past 20 years, but it also failed to adjust the existing ones for inflation.

Because these taxes have not been raised sufficiently since 1951 to keep pace with inflation, consumers of alcohol, beer, wine and cigarettes have paid less tax on these products in real dollars. Meanwhile, the health related costs associated with their consumption have placed a strain on the federal treasury.

A. ALCOHOLIC BEVERAGES

Under present law, federal excise taxes are levied at a non-indexed, flat rate on the production or importation of alcoholic beverages: distilled spirits, wine and beer. With one exception the federal tax on alcoholic beverages has remained constant since 1951. As a result, after adjusting for inflation, these taxes generate 40 percent less revenue today than in 1951.

Like many other Americans, older persons would prefer that "sin taxes" be increased before income tax rates are raised. AARP recommends that the distilled spirits tax be doubled to compensate for inflation; that the excise tax rates on wine and beer be based on alcohol content like the present distilled spirit tax; and then equalized with distilled spirits. Finally, we also suggest that any newly-established alcohol tax rates be indexed for inflation.

Studies show that higher alcoholic beverage prices discourage consumption, especially among the young. Alcohol abuse causes automobile accidents, cirrhosis of the liver, increased crime, increased domestic violence and increased family and personal stress. It also drains government revenue by raising federal medical costs, and it affects the economy through lost productivity.

B. CIGARETTE TAX

The present tobacco product excise taxes are imposed as a flat, non-inflation adjusted rate on cigars, cigarettes, papers and tubes, snuff and chewing tobacco manufactured in or imported to the United States. The tax on "small cigarettes" generates substantially all of the federal revenue from excise taxes on this product class.

Like alcoholic beverage taxes, these taxes have been increased only once since 1951. As a result, the effective tax rate today is lower than in 1951. If the tax rate had been adjusted for inflation, then the cigarette excise tax would be 34 cents per pack instead of the current 16 cents.

AARP supports a doubling of the current tax on small cigarettes and the subsequent indexing to inflation of the new rate. Our members consistently have supported a cigarette tax rate increase for very much the same reasons that they endorse one for alcoholic beverages. They recognize that the product's price influences the level of consumption; higher prices deter smoking among the young especially and, to a lesser degree, among adults.

Also, cigarette smoking has been linked to numerous illnesses such as lung and related cancers, chronic lung diseases, and even premature births. Given these serious health problems and their related medical costs, smokers should help underwrite a greater share of the taxpayers' burden. Moreover, passive smoking poses health risks to nonsmokers. Finally, cigarette smokers have higher absentee rates than nonsmokers, which means a loss in productivity.

The Association recognizes that an increase in the cigarette tax rate, like one for alcoholic beverages, could be attacked as regressive. While a tax increase of this nature exacts a greater percentage of the disposable income of lower income taxpayers, the tax is placed on a discretionary item. Furthermore, the consequences of foregone consumption are beneficial to the taxpayer and to society.

Over and above any increases, the Association urges Congress to permanently index new cigarettes tax rates. This change would eliminate the need for future ad hoc adjustments.

C. TELEPHONE TAX

The present 3 percent excise tax on local and long distance telephone service will expire on December 31, 1987. AARP recognizes that Congress may well need to extend the current tax. However, the Association would oppose any further increases in the individual rate regardless of how small.

In today's world, the telephone has become a necessary expenditure -- an essential for day-to-day living. The infirmed and homebound, usually the poorest among older Americans, especially rely on the telephone as their link with the outside world. Frequently, they forego other items in order to afford a telephone. These people and other low-income persons of any age would be hard hit by a telephone tax increase. If Congress decides to seek additional telephone tax revenue beyond an extension, we suggest increasing business rates above those for individuals and specifically targeting mobile phones for a stiffer rate increase.

D. AIRPORT AND AIRWAY TRUST FUND EXCISE TAXES

The President's budget proposal would extend the current taxes that are deposited in the Airport and Airway Trust Fund for two years. These taxes include an 8-percent tax on passenger transportation; a 5-percent tax on the domestic air transportation of property; a $3-per-person international departure tax; a 12-cents-per-gallon tax on gasoline used in noncommercial aviation; and a 14-cents-per-gallon tax on non-gasoline fuels used in noncommercial aviation.

The Association believes the committee should adopt the Administration proposal. Further, we would ask that you also consider increasing some of these taxes and funneling the revenue into the general fund. Also, the Administration proposal to impose a $1 tax on international air and sea travel could be substantially expanded and the revenue deposited in the general fund. While this does represent a departure from the trust fund earmarking principle, the Congressional Budget Office study on excise taxes indicates that an increase in the airline excise tax is mildly progressive as a percentage of family expenditures. These options would avoid unduly burdening low income taxpayers.

E. SECURITIES TRANSFER EXCISE TAX (STET)

An excise tax on securities transactions has been suggested as a potential source of revenues. A transfer tax of this type was in place from 1918 until 1965, and is common in other industrialized democracies. The STET, which could be a simple one-half of one percent tax on the value of securities transactions, has the ability to raise significant revenues, up to $22.5 billion over a three year period. Moreover, the STET appears at first glance to be a progressive means of raising revenue, as the ability of individuals to engage in securities transactions depends primarily on income. However, the largest traders of instruments subject to the STET now belong to institutional investors, particularly pension funds.

A STET would impact on a pension fund in at least three ways. First, a STET would increase the costs of managing a pension fund. As transactions became more expensive, a smaller share of the fund's gross income would return to the fund on behalf of the fund's beneficiaries. Second, the STET would have a dampening effect on the investment practices of professional fund managers. Pension funds have experienced exceptional growth in recent years; this growth is largely the result of fund managers taking full advantage of favorable market conditions.

Because of the importance of favorable pension fund performance to the nation as a whole, it would be unwise to create any disincentives to the management of such funds. Finally, a STET is expected to cause a reduction in the value of traded securities as investor interest in the purchase of securities declines. The biggest losers from the expected drop in stock prices would be institutional investors, particularly pension funds.

IV. ENERGY TAXES

Taxing energy products may become necessary in order to meet the $19.3 billion revenue target. While energy taxes are large revenue raisers that promote conservation and reduce our foreign oil dependence, they also have distinctive drawbacks. Not only are such taxes regressive and inflationary, but they have uneven effects on different regions of the country and different sectors of the economy; and, in some cases, on different age groups.

A. OIL IMPORT FEE

In 1982 the United States' oil imports declined to 28 percent, their lowest point in many years. For the next few years, oil imports remained around 30 percent. However, American consumers began using more energy when the per barrel oil price dropped markedly in 1986. The sharp price decline not only spurred oil imports but also reeked havoc in oil producing states.

Supporters of an oil import fee argue it would lessen our foreign oil dependence, encourage domestic production and exploration, and promote conservation. Presumably increased domestic production would revive the sagging economies of the oil producing states.

Opponents of an oil import fee, on the other hand, point out that it is regressive and inflationary. Increased fuel prices for petroleum (and even alternate energy forms) and the probable higher costs of petroleum-based products resulting from the tax hurt all consumers, especially low income persons. Furthermore, the increased production costs for energy intensive industries throughout the nation could raise the price of manufactured goods with substantial petroleum or petroleum based contents, and presumably reduce our economic competitiveness.

An oil import fee would place a larger burden on the eighteen oil dependent states (mainly located in the Northeast and North Central regions) which are non-oil producers and which also lack energy resources. These states rely on petroleum for 60 percent of their energy needs. An oil import fee would saddle these states' residents with substantially higher heating bills.

Finally, critics contend that the net revenue potential of an oil import fee has been exaggerated. They note, for example, that the cost of some discretionary spending programs and, more importantly, inflation sensitive federal welfare and entitlement programs would rise to reflect increasing prices. Also, potentially smaller industrial profits from those energy dependent sectors of the economy, in turn, reduce federal income tax receipts.

The impact of an oil import fee upon the elderly is especially acute. While studies show that older persons consume less energy per capita than other Americans, they pay a larger proportion of their income for energy expenses than do younger persons. Conservation of energy is often an impractical solution because it endangers the more fragile health of many older persons who are uniquely affected by lowered temperatures in the winter or raised thermostats in the summer.

In the event Congress adopts an imported oil fee, it is imperative that safeguards be provided to protect the vulnerable elderly. Possible options include a rebate for home heating oil or some other targeted relief for the elderly poor, possibly through the Low Income Home Energy Assistance Program.

B. GASOLINE TAX

Since a gallon of gasoline costs considerably less than it did several years ago, some believe the effects of an increased gasoline tax would be relatively painless. They point out that the federal gasoline tax has remained well below rates levied outside the United States. Additionally, a gasoline tax tends to treat different sectors of the economy more evenhandedly and would have relatively little effect on our international competitiveness. Also, the tax can be collected more easily than an oil import fee because a mechanism is already in place. Furthermore, the discretionary nature of some driving, especially for non-work related purposes, permits persons to control their tax burden somewhat. Finally, to the extent that some low income households do not own automobiles, the impact of the tax will be avoided.

However, like an oil import fee this option is inflationary, and regressive. Also, it is regionally disparate, dispropor-tionately affecting those residing in the West and Southwest. Moreover, it infringes on a tax base traditionally used by states, which currently face the need for added revenue in order to provide programs and services curtailed by the federal government. In fact, 10 states already have raised their gasoline tax rates this year, and possibly 2 others are considering it.

V. INCOME TAX RATES

A. DIRECT TAX RATE CHANGES

Despite the considerable and formidable announced opposition to such a move, some advocate raising revenue by adjusting the tax rates adopted in 1986. This change could be effected by either freezing temporarily the 1987 tax rates or possibly by increasing the new top rate.

At this time, the Association opposes any upward adjustment in the individual tax rates or changes in the current schedule of rates under TRA, especially for the bottom rate. A generalized rate hike would be most burdensome to the lower income taxpayer. Also, this change would contribute to taxpayer uncertainty and cynicism about the stability of the new tax rates.

While it may be possible to implement a rate hike in a manner that would protect those least able to pay, this option should not be considered except as a last resort. If tax rate changes are considered seriously, we would prefer increasing the top corporate rate or subjecting more individual income to the top tax rate as a more equitable means of raising revenue.

VI. ADMINISTRATION'S REVENUE PROPOSALS

The Administration's Fiscal Year 88 Budget proposal contains a number of revenue provisions which would raise around $39 billion. Over 3 years AARP believes that some of these recommendations should be included in the committee's package.

A. MANDATORY MEDICARE COVERAGE FOR STATE AND LOCAL EMPLOYEES

President Reagan proposes to extend Medicare coverage on a mandatory basis to all employees of state and local governments not otherwise covered under current law without regard to date of hire. As a result, effective January 1, 1988, employees and employers would become liable for the hospital insurance (HI) portion of the Federal Insurance Contributory Act (FICA) tax.

AARP has previously endorsed mandatory coverage of current state and local government employees under the HI program. Mandatory Medicare coverage of these employees would increase fairness in the program and improve health coverage.

Despite the fact that Medicare coverage is currently optional for state and local employees, over 90 percent of these employees eventually become eligible for Medicare even though they may have contributed very little to the system. Consequently, these employees who receive full Medicare coverage but do not pay the HI tax for their entire working careers are unfairly subsidized by other retirees who have worked under Social Security and paid the HI tax for their entire working career. Imposing the HI tax on state and local employees would redress this inequity.

Extending the HI tax to state and local employees would likely improve health coverage for those 10 to 15 percent of state and local employees who never gain Medicare coverage and for those retired state and local employees who receive health insurance coverage from state and local plans. Evidence exists that Medicare provides more comprehensive health insurance coverage than state and local plans can afford for their retirees. Moreover, Medicare coverage is portable. State and local employees who change jobs and would lose eligibility for benefits under state and local plans would find Medicare coverage advantageous.

For the above reasons, AARP favors the proposal for mandatory Medicare coverage for state and local employees.

B. FICA TAXES FOR CERTAIN EMPLOYEES

The administration suggests repealing various current law FICA tax exemptions. These proposals have been approved by the Social Security Subcommittee, and the Association recommends their adoption by the full committee. If the committee acts favorably, effective January 1, 1988 wages received by Armed Forces reservists on active duty, certain earnings from family employment, and wages for specific types of agricultural employment will no longer be exempt from the FICA tax. Affected employees would be covered by Social Security and could earn coverage credit.

AARP supports universal Social Security coverage not only because it protects non-covered employees but also because it increases equity for covered wage earners. We hope the Committee will also explore other existing FICA tax exclusions that could be integrated into the revenue package.

C. PENSION BENEFIT GUARANTY CORPORATION (PBGC)

The Pension Benefit Guarantee Corporation (PBGC) plays a valuable role in safeguarding the defined-benefit plan promise for pension participants. Under current law, if a defined benefit plan is terminated by an employer with insufficient assets, then the PBGC guarantees payment of certain benefits. Part of PBGC's revenue comes from per-participant annual premiums, currently set at $8.50.

Due to a recent wave of terminations of plans with large unfunded liabilities, particularly in the steel industry, PBGC is operating at a deficit. Current minimum funding rules need to be tightened to help prevent a similar situation in the future. In addition, terminations for reversions need to be restricted, and any such terminations should include a higher excise tax and enhanced benefits for plan participants.

The current PBGC deficit requires more than funding reforms for the future. Therefore, a package of funding reforms should also be accompanied by an increase in the premium. A flat premium, reflecting the social insurance nature of PBGC, is preferred to a variable rate premium. In addition, a variable rate may be too burdensome in that it will require currently distressed plans and employers, unable to meet the higher payment obligations, into prematurely terminating a pension plan. A flat increase in the premium is recommended to help PBGC meet its benefit obligations.

VII. ADDITIONAL SOURCES OF TAX REVENUE

A. ESTATE TAX

The estate tax has become a decreasing source of revenue since the Economic Recovery Tax Act of 1981. Estate tax revenues fell from around two to less than one percent of federal revenues from 1980 to 1986. The 1981 changes included lowering the estate tax rate from 70 to 50 percent (the rate decrease was frozen at 55 percent until 1988 by DEFRA) and increasing the unified estate tax credit so that estates valued at up to $600,000 could escape taxation entirely. These changes are estimated to cost the government an estimated $46.4 billion in revenues from 1986 to 1991. The number of estates paying any estate tax at all has fallen from 35,148 in 1983 to 30,518 in 1985.

The committee may wish to consider modifying the estate tax system as part of a larger revenue package. An option which should be considered is to retain the present 55 percent top rate, rather than allowing the scheduled drop to a 50 percent top rate to occur.

Another revenue measure that should be included is a correction of a TRA-created employee stock ownership plan (ESOP) loophole. Originally intended as a provision to encourage sales of stock to employee stock ownership plans, the current loophole allows tax planners to assist their clients in avoiding payment of estate taxes. Current law, already tightened by IRS rules early this year, still permits estates owning stock in companies with ESOP's to sell the stock to the plans and exempt part of the proceeds from the estate tax.

The loosely drafted provision, never intended to have such broad application, or to result in large revenue losses, is expected to cost about $7 billion over five years. The ESOP provision should be amended to reflect its limited intent.

B. LUXURY TAX

In the past, the United States has made limited use of the luxury tax as a revenue source and also has levied excise taxes on a wide range of goods considered luxury items. A luxury tax could be reinstated on the purchases or resales of selected items above a certain price: boats, airplanes, automobiles, furs, jewelry, electronic equipment and entertainment devices. The tax could be a flat percent or apply to the cost in excess of specified thresholds; the rate of taxation would be determined by the revenue to be raised.

Some find a luxury tax attractive tax because it primarily affects upper income consumers and is levied on discretionary purchases. The Association recognizes the limited revenue such a tax could raise, but we ask that Congress examine it as a way of shielding lower income taxpayers from additional tax burdens, and because it would enhance the progressivity of a total package of revenue increases.

C. CONSUMPTION TAX/VALUE ADDED TAX

Various people advocate a consumption tax on goods and services rather than income. A value added tax (VAT), one type of a consumption tax has been widely recommended. A substantial revenue raiser, this tax has various drawbacks that counterbalance its tremendous revenue potential. These include its regressivity, its hidden nature, the impact on those with a fixed income, and, finally its inflationary nature. A consumption tax seriously departs from current tax policy and also would be extremely difficult to implement. The Association strongly rejects efforts to reduce the deficit through any type of consumption tax.

VII. CONCLUSION

The Association has in the past supported responsible revenue raising packages such as the Tax Equity and Fiscal Responsibility Act (TEFRA) and the Deficit Reduction Act (DEFRA), as well as the base broadening provisions of TRA. They help restore lost revenue in an equitable and efficient manner. Continued deficit reduction is essential.

The options cited in the testimony which the Association supports exceed the $19.3 billion target mandated by the FY 88 budget resolution. We believe they are equitable, pro-growth and manageable alternatives.

AARP looks forward to working with this Committee as it develops a revenue raising package that we hope represents both sound tax policy and social policy goals.

Statement of the
American Bankers Association
Submitted to the
Committee on Ways & Means
U.S. House of Representatives
On Revenue Increase Options
July 15, 1987

The American Bankers Association (ABA) is pleased to submit its views on the possible options to increase revenues under consideration by the Committee on Ways & Means in connection with the Fiscal Year 1988 Budget Resolution. The ABA is the national trade and professional association for America's commercial banks of all sizes and types. Assets of ABA members banks comprise about 95 percent of the industry total.

In reviewing the revenue increase options contained in the Joint Committee on Taxation (JCT) staff options booklet, JCS-17-87, the ABA has two overall concerns that recur in our analysis of the specific proposals.

First, proposals which raise only minimal revenues and which change long-standing fundamental provisions of the Code are not appropriate for a budget reconciliation measure.

Second, in fairness to taxpayers, any new proposals should not apply to transactions consumated prior to the date of enactment of the Budget Reconciliation Act, or at the earliest, the day the Ways & Means Committee reports out the bill. Proposals which have a retroactive effect unfairly penalize taxpayers by altering the taxation of existing investments and on-going transactions.

We believe these two general principles are important elements in maintaining sound tax policy as the Committee approaches the task of reporting out legislation which raises revenues as required in the FY 1988 Budget Resolution. If revenues must be raised, the objective should be to do so while avoiding to the maximum possible degree undue complexity, and retroactivity.

The ABA submits its views on five specific revenue options described in the JCT booklet of June 25, 1987.

Amortization of Intangibles

The ABA strongly opposes the proposal to deny or severely limit the amortization of "customer-based" intangible assets purchased in a taxable merger or acquisition. This proposal would retroactively cut-off hundreds of bank tax cases in various stages of IRS audit or pre-trial litigation concerning the amortization of costs associated with the acquisition of a bank "core deposit base." These bank mergers or acquisitions were negotiated, priced and consumated under existing tax law which permits an amortization deduction of the cost of intangible assets if, and only if, the taxpayer can prove that the asset has a determinable value and measurable useful life. We oppose this option not only because it is retroactive in its effect, but also because it constitutes a complex change in a long-standing and fundamental tax rule which generates an insignificant amount of revenue within the three year budget period.

The distinction in the existing tax law between amortizable intangible assets and those which are non-deductible like goodwill has been developed over a long period of time and is adaptable to a variety of unique situations. In Rev. Rul. 74-456 the IRS underscored the usefulness of this basic rule in the context of so-called customer-based assets. The ruling points out that such assets are generally an indivisible part of the whole business, with no determinable life and, therefore not subject to amortization. The ruling goes on to state, however, that if the taxpayer can demonstrate that the asset is susceptible to valuation and is of use in its trade or business for a measurable limited period of time, a amortization deduction is allowable. Thus, the deductibility of the costs associated with any intangible asset turns on factual issues best determined on a case by case basis, by the IRS or the courts, using the long-standing principles of the Code.

In the banking industry core deposits are intangible assets recognized by the federal bank regulators and the accounting profession. See OCC Banking Circular 164, July 1, 1985. The deposit relationship is an extremely valuable component in the profitability of any bank. Deposits provide a ready source of funds from which a bank can generate a future income stream and a deposit relationship becomes an avenue for selling the bank's income producing services. Competition for deposits by money brokers, non-banks and banks operating from outside the geographic market have forced banks to devote more resources to maintain their markets. Thus, core deposits are a diminishing asset with a limited useful life. Banks can determine the value and expected life of an established deposit base acquired by a new entrant into a banking market. A purchasing bank would normally pay a premium for the acquisition of these deposit relationships and upon showing value and useful life, should be entitled to an amortization deduction. In acquisitions of failing or failed banks where FDIC assistance is provided, the payment of a premium for the deposit liability is required. Since the purchaser would be recording the assets and liabilities at fair market value, it should have the opportunity to prove that it has acquired an amortizable asset separate and apart from goodwill. If legislation is adopted which precludes any amortization deduction, purchasers will be reluctant to pay the current level of FDIC premiums.

The IRS has raised the core deposit issue in many bank audit situations around the country. A few have already been litigated, but three key cases, with clear facts, are going to trial this Fall. Any legislative action now would pre-judge the application of long-standing tax rules to these already existing bank core deposit cases. If the proposal were made applicable to future amortization of these existing bank assets, it would, in effect, retroactively increase the cost of those assets to the acquiring bank. In light of the significant number of bank merger and aquisitions which have resulted from the breakdown of state law barriers and the decreased profitability of banking, Congress should not take action which would increase the cost of these acquisitions ex post facto.

Customer Interest Expense Deduction on Home Equity Loans

Since the adoption of the qualified residence interest expense rules in the Tax Reform Act of 1986, there have been concerns about both the fairness of the provision and the difficulty taxpayers (and the IRS) will have determining the amount deductible on tax returns. The ABA believes that pending proposals to further limit the deductibility of interest on home equity loans will not resolve Congressional concerns about the fairness of present law. Moreover, the ABA urges Congress not to require financial institutions to report additional information on interest paid on home equity loans. The experience with the new tax law, as applied to a developing market of home equity loan products, is insufficient to justify further legislative change.

Home equity loans are not really new loan products, but rather a derivation of the traditional second mortgage. Over the past few years the second mortgage has been redesigned to reflect changes in the credit market and to better meet the needs of customers. The second mortgage exists now as a home equity installment loan, or as a home equity line of credit. The revolving credit line permits a consumer to borrow and repay as need requires, usually for a specified period which may range from five to ten years. During this period the borrower pays interest only, or a portion of the principal plus interest. The interest rate is often a variable rate which is indexed to a short-term market rate, although consumer reluctance regarding variable rates has led some banks to offer fixed rate credit lines. After the revolving credit period, the balance may convert to a fully amortizing loan, or may be required to be paid in full, a balloon payment.

Home equity loans are popular not only because of the tax deductibility but also because the revolving line feature and the higher credit limit available on home equity loans give consumers the ability to access a non-liquid asset and accommodate most of their lending needs on their own, without repeated visits to the bank. The customer can access the money (with a check, a coded telephone call or credit card) and make repayments without ever interacting with the banker again. Interest is paid only when there is a loan balance, and only on the amount of credit needed at any given time. Home equity loans may also offer borrowers more competitive rates than other consumer loans, and a longer repayment term. In order to make sure that consumers fully understand both the opportunities and complexities of home equity loans, the ABA has undertaken a broad public awareness campaign urging that banks be very clear and accurate in their advertising. The ABA has urged banks to provide consumers with the information necessary to make a wise borrowing decision. The ABA has also urged consumers to avoid debt overload, temptation toward frivolous spending and borrowing solely motivated by tax advantages.

Bank customers need to understand the tax rules not only in the context of their borrowing decisions, but also to properly figure their tax deductions. Financial institutions are already required by DEFRA 1984 to report to the IRS and to the payors, interest paid on debt secured by real estate. Banks do not have the information necessary to further insert themselves into the process of determining whether or not that interest is tax deductible. The structure of a typical home equity loan does not lend itself to any requirement that the bank track the use of the proceeds. In determining whether or not line a of credit is to be approved, the bank is concerned about the fair market value of the property securing the loan, the amount of other debt for which the property is security, and the gross income and cash flow of the borrower. In fact, the bank has no control over the actual expenditure of the funds. It is not even possible for a bank to track the use of the loan based on the checks drawn, as it would not insure that the payments were made for qualified tax expenses.

The information necessary to compute deductible mortgage interest expense can only be provided by the individual using the loan proceeds. The bank does not need this information to make its credit decision and cannot reasonably be expected to accept either the responsibility or the underlying liability for determining the deductible portion of a customer's interest expense payments.

Securities Transfer Excise Tax

The securities transfer excise tax (STET) is a new revenue option growing out of the stock transfer tax proposed by the Speaker of the House earlier this year. While the details of the proposal are not spelled out in the JCT booklet, it appears that the STET would have major economic significance, apart from its revenue potential. The STET proposal should be subject to considerable analysis and debate in a public forum instead of being incorporated into budget reconciliation legislation which is designed for expedited action in the Congress.

The ABA comments on this proposal are designed to raise, on a preliminary basis, the concerns which we believe ought to be examined in depth if the Committee on Ways and Means decides to pursue the option. At the outset, the Committee would want to analyze broad macroeconomic issues such as the impact of the tax on future savings and investment of capital and the operation of the capital markets at a time when we need more capital to finance our growing debt burdens. Beyond these broad economic considerations the ABA is concerned that the STET would have some very serious impacts on financial institutions, their products, their liquidity through the federal funds market and their asset and liability management.

The STET, as briefly described, may apply to both equity and debt instruments, whether or not publicly traded. While the Documentary Stamp Tax which was repealed in 1965 exempted all certificates of deposit (see then existing regulations section 43.4311-2(b)(5)), it appears that the STET could apply not only to negotiable CD's but also passbook savings accounts, credit card charges and other routine transactions between the bank and the consumer. Extending the tax to these consumer transactions of 200 million accountholders would have a significant impact on the average citizen.

The impact of the STET on consumers would be even greater if it applied to both the original issuance and secondary market transfers of debt instruments. It would seem to be a curious message about government policy on savings to tell a customer that there is a tax when he opens a passbook account, obtains a CD, or makes additional deposits.

The application of the tax to the issuance and resale of government debt obligations also raises serious questions. Would the US Government pay a tax on the issuance of T-bills and Treasury obligations and notes? These debt obligations are marketed by the commercial banks serving in the role as dealers, both in the US and worldwide. Would the banks also have to pay the tax on the secondary transfer from the dealer bank to the investor? The same considerations apply in the case of state and local obligations marketed by banks, plus the added concern about the constitutionality of taxing transfers of such debt.

Another concern about the scope of the tax involves the possible application to overnight federal funds transactions by commercial banks. Federal funds are bank balances on the books of the Federal Reserve banks. Commercial banks that have excess reserves lend those reserves, usually overnight, to other banks with deficiencies in their reserve positions. This represents an alternative and more productive use of funds that banks may have idle for short periods. Applying the tax on these transfers would put a premium on precisely determining reserve balances, a goal that is difficult if not impossible to obtain. Banks could find themselves in the position of paying a tax for the liquidity that is available through the federal funds market.

The possible application of the STET to futures, forwards and options raises a number of concerns about its impact on bank asset/liability management. Commercial banks participate in futures markets subject to federal bank regulations. Futures instruments are crucial for banks which hedge positions to protect themselves against the risk of interest rate or currency exchange rate fluctuations. For example, an asset such as an investment portfolio would decline in value as interest rates rise. A bank can protect itself against this asset depreciation by taking a short position in the futures market so that as prices fall the loss in the cash market is offset by profits in the futures market. On the other hand assets such as loans are at risk when interest rates fall.

These same principles apply in trading account activities, debt issuance, trust management and mortgage banking. Application of a tax on these hedging actions designed to reduce bank risks will not only increase bank costs, but also make the futures market less efficient and likely reduce its correlation with the cash market. At a time of significant fluctuations in interest rates and currency exchange rates, any proposal to tax the actions necessary to reduce risk of loss would be contrary to maintaining a safe and sound banking system.

Full review of the impact to the STET on financial institutions should include consultation with the Treasury Department and the federal regulatory agencies responsible for supervising the nation's commercial banks.

Withholding Tax on Interest Paid to Foreigners

The ABA urges the Committee to reject any proposal to impose a low rate of tax on interest paid to foreigners which is presently exempt from the 30% withholding tax. Sections 871 & 881 of the Code now specifically exempt interest on non-resident alien bank deposits, portfolio interest, and short-term original issue discount (on obligations with maturities of 183 days or less), while certain other interest payments are exempt by means of bilateral tax treaties. These provisions are designed to attract foreign capital investment to meet the credit needs in the U.S. As a result, both corporate borrowers and the U.S. Treasury have been able to raise substantial funds from foreign investors at lower interest rates. The imposition of even a low rate tax on these interest payments to foreign investors would create a disincentive to acquire obligations issued by U.S. borrowers and place unnecessary pressure on the U.S. debt markets. The possible benefit from increased revenue collected under such a tax would be outweighed by the substantial economic cost of higher interest rates and would be off-set in a revenue sense by increased interest deductions.

Congress has historically endorsed a policy to allow certain U.S. borrowers to compete for foreign capital on a tax-free basis. Most notably, since 1921 foreign persons have been exempt from U.S. tax on interest on deposits from U.S. banks, saving and loan institutions, and similar financial institutions. According to Treasury Department testimony, this exemption for bank deposit interest reflects the need to keep the international competitiveness of U.S. financial institutions. To impose a U.S. tax on interest paid to foreign persons by U.S. banks would reduce the ability of U.S. financial institutions to compete for foreign funds and would seriously erode the efficiency of international capital markets. In the 1986 TRA Congress revised the form of the exemption for interest on bank deposits, changing from a source rule provision to a statutory exemption, but no consideration was given to eliminating the exemption for interest on bank deposits.

The portfolio interest exemption adopted in 1984 is equally important. Under that provision all borrowers (Treasury, Government agencies and corporations of all sizes) can now issue debt obligations directly out of the U.S. for sale to foreign investors. These U.S. borrowers can benefit from a healthy competition between the U.S. domestic and Eurobond capital markets which results in overall lower interest rates, greater liquidity, and a broader market for their obligations. The Treasury Department testimony before this Committee in 1984 in strong support of the portfolio interest exemption was based on its view "that efficient capital markets are an important element in achieving both increased capital formation and sustained economic growth in the United States. Access to foreign capital in such markets requires that interest on borrowed funds be available free of source-country taxation."

The substantial inflow of foreign funds in the form of portfolio investments have been of critical importance in meeting the needs of U.S. borrowers--both Government and private. In particular U.S. financial institutions have raised between $10 and $20 billion in the Eurobond market since the repeal of the 30% withholding tax on portfolio interest. U.S. thrift institutions have marketed their obligations collateralized by Ginnie Mae certificates at rates lower than rates on funds available in the U.S., and at the same time diversifying their sources of funds.

At a time when there is a tremendous capital deficit in the U.S. and when the declining value of the dollar discourages some foreign investors from taking the dollar-denominated debt, no additional barriers to foreign capital should be considered. The recent flap over the notice of termination of the U.S.-Netherlands Antilles Tax Treaty, which may result in application of the 30% withholding tax on pre-DEFRA Eurobonds, should be clear evidence that the present exemption from the tax is crucial to encouraging foreign portfolio investment in the U.S.

Taxation of Credit Unions

The President's 1985 Tax Reform proposal included a recommendation that credit unions having assets of $5 million or more should be taxed like other thrift institutions. This proposal is included in the JCT booklet on revenue options, with a revenue estimate of $1 billion over three years. The tax-exemption for credit unions was adopted in 1951, when credit unions were small institutions with limited powers serving limited markets which did not compete with other types of financial institutions. In light of the fact that now credit unions compete directly with commercial banks and thrifts, the ABA recommends the Committee reconsider and repeal the tax exemption for credit unions. The ABA will submit a detailed statement on this issue to the Oversight Subcommittee in connection witn its specific hearings on organizations which use their tax-exempt status to unfairly compete with taxable businesses.

* * *

Our Association appreciates the opportunity to submit a statement on the revenue increase options. Additional information can be obtained from Henry Ruempler, Tax Counsel, American Bankers Association, 1120 Connecticut Ave., N.W., Washington, D.C. 20036, (202) 663-5317.

STATEMENT OF
NORMAN R. SHERLOCK,
PRESIDENT AND CHIEF EXECUTIVE OFFICER
THE AMERICAN BUS ASSOCIATION
BEFORE
THE COMMITTEE ON WAYS AND MEANS
ON
OPTIONS TO RAISE REVENUES IN ORDER TO MEET THE RECONCILIATION INSTRUCTION TO THE COMMITTEE ON WAYS AND MEANS IN THE CONCURRENT RESOLUTION ON THE BUDGET FOR FISCAL YEAR 1988

JULY 15, 1987

I appreciate this opportunity to comment on the Administration's revenue increase proposals contained in the President's Budget for Fiscal Year 1988 and the revenue options presented for consideration by the Ways and Means Committee in connection with the reconciliation requirements relating to the revenue targets contained in the fiscal 1988 Budget Resolution. The American Bus Association ("ABA" or "the Association") represents more than 3,500 companies involved with bus regular route, tour and charter, airport and commuter services and in businesses which are related to travel and tourism.

I. Administration and Ways and Means Proposals

In its fiscal 1988 budget proposal, the Reagan Administration has outlined a number of revenue raising proposals, including the repeal of all existing Highway Trust Fund excise tax exemptions. Exemptions from excise taxes, particularly the 12 cent per gallon diesel fuel excise tax exemption, are essential to maintaining a financially healthy and viable intercity bus industry as part of the national transportation network.

The amount that would be raised by eliminating this exemption - $30 million - is not enough even to warrant an asterick in the national budget, but it is important to thousands of small, struggling bus companies. For many, the savings represent their profit. A quick look at the newspaper over the last six months illustrates the fragile economic condition of the bus industry and the recent buy-out of the financially distressed Trailways Lines, Inc. is further indication.

According to the Interstate Commerce Commission, operating revenue and ridership of 10 of the largest bus companies substantially declined in 1986 compared to 1985. Operating revenues fell 10.5 percent and passangers carried fell 17.7 percent. Net income dropped by $10.2 million to $35.1 million.

The American Bus Association urges that Congress again reject any proposal to repeal the intercity bus industry's exemptions from excise taxes.

In addition, included among the revenue raising options submitted by members of the Ways and Means Committee is a proposal to increase excise tax rates. Specifically, possible proposals include: (1) increasing by 5 to 10 cents per gallon the excise taxes on all motor fuels used in highway uses; (2) indexing the taxes for inflation using the Consumer Price Index after the tax increase is implemented. The options also include a proposal that diesel fuel continue to be taxed at current rates.

The revenue raising options also include a proposal that would require that wholesale dealers collect the diesel fuel excise tax. Under current law, the tax is collected and paid at the retail level. The Association supports efforts to improve the efficient administration of the diesel fuel excise tax.

As an initial matter, ABA objects to an increase in highway user taxes for non-transportation purposes. It should be noted that the highway program has not contributed to the deficit. The American Bus Association opposes any increase in the diesel fuel excise tax. Dedicated Highway Trust Fund money should not be diverted, as these monies are needed for road and bridge repair and construction.

II. The Intercity Bus Industry Plays a Vital Role in Our Nation's Transportation System

As outlined below, the intercity bus industry can ill afford an increase in taxes. ABA maintains that an increase in the diesel fuel excise tax is regressive, as an increase in the cost of intercity bus transportation will disproportionately impact passenger service which is characteristically provided to lower income and rural area travelers.

Congress has repeatedly expressed its support for the transportation policy goals embodied in the excise tax exemptions as evidenced by the rejection of last year's proposal to repeal the excise tax exemptions made by the Administration. For these and the following reasons, the American Bus Association urges that Congress again reject the proposal to repeal these exemptions and to reject the proposal to increase the diesel fuel excise tax.

Historically, Congress has urged the use of private intercity bus transportation. The Energy Tax Act of 1978, the Highway Revenue Act of 1982, and the Tax Reform Act of 1984 all contain provisions exempting intercity buses from all or part of the diesel fuel excise tax and from other highway user taxes.

Most recently, Congress acted to extend these exemptions as part of P. L. 100-17, the Surface Transportation and Uniform Relocation Assistance Act. During consideration of this Reauthorization Act, the House and Senate tax writing committees considered the question of repealing or reducing these exemptions in order to raise revenue for highway and transportation programs. They decided that there was no need to take this step for either revenue raising or for tax equity reasons.

This national policy stems from Congressional recognition that the intercity bus industry plays a unique and vital role in our nation's transportation system. Private intercity bus operators must compete with subsidized mass transit operations and other subsidized forms of transportation for tour and commuter passengers.

The Office of Management and Budget estimates that the repeal of all existing highway excise tax exemptions would yield $800 million in increased receipts to the Highway Trust Fund in fiscal 1988. In regard to exemptions extended only to the bus industry, the Congressional Budget Office estimates that repeal would yield actual additional revenues of only $100 million in fiscal year 1988, the bulk of which is attributable to public transit. CBO estimated last year that the elimination of exemptions for the private intercity bus industry would provide only a very small portion of that figure -- approximately $30 million. Clearly, the excise tax exemptions extended to the intercity bus industry are not large revenue losers when measured in terms of the federal budget.

More than 375 million passengers ride intercity buses annually. In comparison with other modes of transportation, intercity buses carry far greater proportions of senior citizens, students, military personnel, and women. An income profile of intercity bus passengers reveals that 58 percent of them have annual family incomes of less than $15,000.

Of the approximately 12,000 points in the United States served by intercity bus service, an estimated 11,000 are not served by any other form of intercity transportation. Based on this information, it is clear that an increase in the diesel fuel excise tax would disproportionately impact rural communities and low income socio-economic groups.

We also wish to point out the energy conservation incentive provided by the diesel fuel excise tax exemptions. Intercity buses are the most fuel efficient from of intercity travel based on passenger miles per gallon of fuel consumed. To the extent that people can be encouraged to utilize intercity bus transportation rather than to drive personal automobiles, energy conservation is achieved. The excise tax exemption allows intercity bus operators to offer low fares which give an alternative to more energy intensive forms of transportation. Any increase in the diesel fuel tax would similarly impair the bus industry's ability to provide low cost transportation. It should be noted that the intercity bus is roughly three times more fuel efficient than Amtrak and six times more fuel efficient than commercial air transport.

Travel and tourism businesses rely heavily on intercity bus industry to bring them business and for many of those businesses it is a critical lifeline. A ten percent decrease in bus ridership would cost these businesses close to $1 billion in revenue annually. As a further result, unemployment would increase dramatically, particularly among the minorities, women and youth who are heavily employed in the travel and tourism industry.

III. Private Bus Companies Receive No Direct Federal Subsidy But Must Compete Routinely with Federally-Subsidized Entities.

The exemptions are the only subsidies which the intercity bus industry receives from the federal government. However, the intercity bus industry must compete with other modes of transportation which receive huge federal subsidies. Specifically, intercity bus operations must compete for passengers with Amtrak and the airlines. Amtrak is directly subsidized at a rate of approximately $35 per passenger. The airlines are subsidized at a rate of approximately $9 per passenger, according to government studies, and have enjoyed large subsidies and favorable tax treatment in past years. Last year, the Administration estimated that the current 12 cent per gallon diesel fuel tax exemption amounted to an indirect subsidy of only 8 cents per passenger for the intercity bus industry.

Additionally, repeal of the bus-industry exemptions or an increase in the excise tax rate would further harm the competitive position of the private intercity bus industry vis a vis public transit authorities if it were not applied to them also. Public transit authorities are increasingly competing with private bus companies on commuter routes and in charters and tours. They enjoy tax exemptions due to their status as governmental entities and also receive large subsidies from the

Federal government. A new subsidy, enacted as part of the Surface Transportation Assistance Act of 1982, has provided public mass transit authorities with revenues equal to 1 cent of the per gallon tax on motor fuels; this amounts to more than $1 billion from taxes imposed on private highway users, including private intercity bus companies. The proposed repeal of these exemptions or an increase in the tax rate would place our industry at a greater disadvantage than ever before.

IV. Proposal to Change Collection of Diesel Fuel Excise Tax.

Under current law, the diesel fuel excise tax is generally imposed on the sale of fuel by a retail dealer to the bus owner or operator. Under an exception created by the 1986 Tax Act, retail dealers may elect to have wholesale distributors collect and pay the tax when the diesel fuel is sold to the retailer. The Ways and Means Committee options include a proposal that would make the election to collect the diesel fuel excise tax on sales by wholesale dealer mandatory for all sales.

Under current law, ABA members must pay the full 15.1 cents per gallon tax upon purchase or use of the fuel, and must later file for a refund or obtain a credit equal to the 12 cents per gallon. Many ABA members experience extensive delays in obtaining their refunds. While ABA supports efforts to improve the efficiency of the collection and administration of the diesel fuel tax, ABA urges that similar efforts be made to improve the efficiency of the Internal Revenue Service processing of the refund claims submitted by bus owners and operators. Alternatively, the ABA suggests that increased savings and efficiency could be achieved by requiring bus owners and operators to initially pay only the 3.1 cents tax which is lawfully due and not impose on the bus owner or operator the added burden of a claim for refund. Such a move would also eliminate the IRS' administrative burden of processing the claims for refund and tax credits.

V. Conclusion

The repeal of the intercity bus industry's exemptions or an increase in the diesel fuel excise tax, in conjunction with the effects of deregulation in the industry, and continuing liability insurance problems, would have a serious financial impact on the private intercity bus industry. Many intercity bus operators are small business people and their businesses would suffer from the financial burden of an increase in excise taxes.

The American Bus Association urges the Committee and the Congress to reject the Administration's proposal to repeal these excise tax exemptions and the Ways and Means proposal to increase the diesel fuel excise tax. The ABA supports the alternative proposal that diesel fuel continue to be taxed at current rates.

STATEMENT OF
THE AMERICAN COUNCIL OF LIFE INSURANCE
AND
THE HEALTH INSURANCE ASSOCIATION OF AMERICA

ON OPTIONS TO RAISE REVENUES
JULY 15, 1987

INTRODUCTION

This statement is submitted on behalf of the American Council of Life Insurance and the Health Insurance Association of America to express our opposition to proposed revenue options which relate to the tax treatment of insurance and employee benefits. We believe the current tax rules in these areas reflect a balancing of important social policy, tax policy and revenue considerations. Moreover, the rules in these areas have been intensively and continuously examined over the past six years and extensively revised by the last three tax Acts. The resulting rules and the delicate balance they reflect should not be dismantled solely out of a concern for revenue.

Individuals should be encouraged to provide for their long-term financial security. Insurance and employee benefit plans are two of the principal means to achieve this. Life insurance provides a means for taxpayers to protect against untimely death; annuity contracts are important means to save for retirement needs; and health insurance protects against financial disaster caused by illness or disability. Employee health and life insurance programs allow the provision of such protection through the work-place. Tax disincentives to providing these valuable protections should not be enacted, particularly at a time when the need for private sector programs is increasing because of cutbacks in social programs and increases in health costs.

The Congress has consistently recognized the importance of encouraging provision for long-term financial security, both through individual insurance and through employee benefit plans. Moreover, comprehensive tax rules have been carefully designed to ensure that life insurance and annuity products qualify for the current tax rules only if they provide such long-term security and that employee benefits, such as group health and group life, so qualify only if they are available for low- and middle-income taxpayers. This policy and its implementation have been constantly reviewed and updated. For example:

1. The Tax Equity and Fiscal Responsibility Act of 1982 extensively revised the tax treatment of annuities and certain life insurance contracts, and began the process of revising the life insurance company tax rules.

2. The Deficit Reduction Act of 1984 included a thorough revision of the tax treatment of life insurance companies and their products. These changes followed over two years of careful study. Moreover, the 1984 Act provides for studies of the operation of the 1984 Act on the taxation of insurance companies and their products. Thus, the tax treatemnt of insurance will continue to be studied, as reflected in the Subcommittee on Select Revenue Measures recent announcement of hearings.

3. During the debate leading to the Tax Reform Act of 1986, basic tax fundamentals for life and health insurance were again reviewed, including the tax treatment of inside build-up, employee benefits, and life insurance company reserves. Significant changes were made in the nondiscrimination rules for employee benefit plans, in the tax treatment of certain insurance products, and in repealing the special life insurance company deduction.

In view of these very recent Congressional reviews and the scheduled re-examination of the insurance tax rules, it does not make sense to re-examine these provisions in the hurried context of budget reconciliation. To a very large degree, the revenue options in these areas were thoroughly examined and debated and acted on in one way or another during consideration of these recent Acts.

For these reasons, we urge that the life and health insurance and employee benefit issues raised in the options be removed from the Committee's agenda. They generally involve small amounts of revenue, but entail complicated, broad and already considered implications for our business and the American public.

There follows a more detailed discussion of some of the possible revenue options relating to the life and health insurance business.

DISCUSSION OF SPECIFIC REVENUE OPTIONS

TAXATION OF INSURANCE PRODUCTS -- (Item II(D)(13)(a))

I. Life Insurance

Several revenue options involve significantly revising the tax treatment of life insurance policies. Three different approaches are suggested: taxing the inside build-up of values in a life insurance policy, redefining what constitutes a life insurance policy for tax purposes, and changing the current framework for taxing distributions and loans from life insurance policies. We strongly believe that current law represents sound tax policy in all these respects and should not be changed.

We understand that some of these proposals may have been suggested in response to recent advertising and marketing of single premium life insurance policies. In this regard, marketing emphasis should not be permitted to blur reality. In fact, single premium life insurance policies conform to the definition of life insurance which was carefully designed in 1984. As such, they do not provide for the accumulation of funds beyond the amount which was deemed appropriate to provide life insurance protection for the whole of life. Moreover, the taxation of distributions and loans under single premium life insurance policies is no different than the tax treatment applicable to all other types of policies, which we believe to be reasonable and to conform to widely applicable tax principles.

A. Current Taxation of Inside Build-up

-- The policy of the United States tax law has been to encourage American families to protect themselves through the private insurance system. This policy was reaffirmed in the Tax Reform Act of 1986 despite Administration efforts to currently tax the inside build-up. The necessary effect of increasing the tax burden associated with life insurance would be to increase its cost and discourage its utilization by those least able to assure their financial security by other means. This would leave a gap in family protection which inevitably must be filled by public programs.

-- Taxing a policyholder currently on the increase in the value of his life insurance policy would be inconsistent with the historical and fundamental concept of tax law that persons are not taxed on unrealized amounts which they cannot receive without giving up important rights and benefits.

-- The reduction in the sale of permanent life insurance stemming from an inside build-up tax would impair private capital formation and economic growth. Life insurance company funds are invested until they are paid in the form of benefits. Life insurance companies have long been a major source of long-term investment capital.

B. Revision of Definition of Life Insurance

-- To qualify for tax treatment as life insurance, a contract must meet the definition set out in Internal Revenue Code Section 7702. This definition was carefully designed in 1984 as part of an overall reform of the tax treatment of life insurance companies, their products, and their policyholders, and was again reviewed during the 1986 Tax Reform debate. Few sections of the Internal Revenue Code have received as much scrutiny as Section 7702. It draws the line that defines life insurance contracts at a proper place, in distinguishing between contracts that serve primarily as vehicles for life insurance protection as opposed to investment return.

-- In recognition of the fact that insurance costs increase with age -- and may become prohibitive at older ages -- premium payment plans under whole life policies can range across the entire spectrum from level payments for life to a single payment at the beginning -- or there may be no prescribed schedule. Section 7702 accommodates all of these variations, and this is entirely proper because it encourages the important social policy of purchasing whole life insurance. Section 7702 achieves this by focusing, not on particular product design features, but on the relationship between the funds accumulated and the benefits provided. Stated simply, the Section 7702 tests limit the funds that may be accumulated under a life insurance contract to those amounts deemed appropriate to provide the future benefits promised under the contract.

-- Section 7702 has had a substantial impact. Following its enactment, several long-standing product designs were totally eliminated -- e.g., endowment and retirement income contracts where any insurance element may disappear during the insured's lifetime. Other products had to be redesigned to put in a greater death benefit (e.g., increasing face amount insurance).

-- The funds in a life insurance contract cannot produce investment results for the policyholder comparable to those which can be realized under an investment vehicle. This is because there is a mortality cost associated with the payment of the death benefit and a cost to the insurance company of administering its insurance business; these costs must be met from the insured's premium dollars or from the company's investment return.

In this regard, one of the revenue options assumes that earning a high yield is inconsistent with life insurance treatment. This is an incorrect perception. The use of a current investment return under life insurance policies is intended to provide lifetime protection at the lowest available cost. Moreover, as already discussed, high investment return cannot be used to build policy accumulations above that permitted by the Section 7702 formulas.

C. Revision of Tax Treatment of Distributions and Loans Under Life Insurance Policies

Distributions. If a policyholder fully surrenders his life insurance policy, any gain in the policy is taxed at that time. Amounts received pursuant to a partial withdrawal or surrender are taxed under a hybrid system. During the first 15 years of the policy, they are taxed under the rules of Section 7702(f)(7)(B). Thereafter, they are considered to constitute first, a withdrawal of the policyowner's investment in the contract and then, a withdrawal of any gain under the policy.

These tax ordering rules are consistent with sound tax policy principles; a universal income first rule should not be adopted.

-- As part of its tax reform efforts in 1986, Congress reviewed the current rules and prescribed a very detailed mechanism for determining when and to what extent taxable income should be recognized before basis is recovered. This mechanism (Section 7702(f)(7)(B)) taxes distributions in the first 15 years of a policy when there is gain in the policy and cash values are at or near the maximums permitted by the definition of life insurance. Thus, it addresses in the distribution context, the problem area that has concerned Congress; that is, the use of life insurance as investment, rather than protection vehicles. Clearly, this problem-specific approach is far preferable to an indiscriminate approach that would adversely affect all types of policies held by individuals at all income levels.

-- Altering the income recognition rules as proposed would be extremely harsh on policyholders. For example, if a policyholder needs to withdraw some funds from his life insurance policy to meet emergency expenses or to pay heavy expenses, such as college tuitions, such a reordering rule could increase his financial burdens by triggering a tax on gain in the policy up to the amount of his withdrawal.

Loans. In addition to withdrawals and surrenders, the owner of a permanent life insurance policy is able to use the values in his policy as collateral for a loan. Such a loan can be made directly from the life insurance company or from a third party. In either case, the loan requires interest payments and must be repaid. The Congress and the IRS have historically recognized that typical life insurance policy loans are loans for tax purposes. Thus, as with loans generally, loans secured by life insurance policy values do not currently result in a taxable event. This result should not be changed.

-- A loan secured by the value of a life insurance policy is like any other loan secured by property. Interest accrues on the loan and must be paid. Moreover, the creation of the debt does not extinguish the policyholder's ownership rights in his policy.

The situation is very analogous to that of a homeowner who takes out a home loan. The homeowner retains the rights and duties of ownership. Similarly, a life insurance policyholder who takes out a policy loan does not surrender any part of his life insurance coverage but remains protected by the policy. If he repays his loan, he is entitled to payment of the full amount of the death benefit without any requirement to re-establish his insurability or to pay higher premiums based on his then attained age. In either case, the only possible rationale for creating a taxable event in the case of a loan is to equate the loan with a sale or distribution of the value of part or all of the underlying collateral. This is simply not what occurs.

-- In the past, proposals have often been made with regard to life insurance policy loans in response to a perceived tax advantage flowing from the fact that the policy loan interest was deductible while the policy's inside build-up was not taxable unless it is withdrawn. This situation was essentially eliminated for all consumer loans and most business policy loans by the 1986 Tax Reform Act. Thus, this issue can no longer justify adverse tax treatment for policy loans.

-- The fact that loans under non-qualified deferred annuity policies are treated as distributions for tax purposes does not justify similar treatment for life insurance policy loans. Congress has specifically defined in Section 7702 the characteristics which distinguish a life insurance policy from an investment motivated vehicle. There is no comparable definition for annuities; instead, Congress has taken an entirely different approach for annuities by crafting special taxing rules to draw the lines it desires.

2. Annuities

Two revenue options would substantially alter the tax treatment of non-qualified deferred annuity contracts. Under one option, an annuity policyholder would be taxed currently on the annual increase in cash value credited to his or her annuity contract (the "inside build-up"). The second option would limit the amount that a policyholder could invest in a newly issued annuity on a tax-deferred basis. These issues have been thoroughly reviewed in the past, and for the reasons discussed below, Congress should, once again, reject the proposals.

A. Taxation of Inside Build-Up

-- In 1982, 1984, and 1986, Congress made substantial changes to the treatment of deferred annuities in order to ensure that annuity contracts are used for retirement purposes and not as short-term investments. As a result of these changes, if a policyholder makes a premature withdrawal from an annuity, the amount withdrawn is considered to come first from currently taxable income. Furthermore, a penalty tax of ten percent generally is imposed on withdrawals that occur before the annuity owner has reached age 59 1/2. Thus, an inside build-up tax is not warranted on the grounds that annuities are, in reality, investments.

-- The deferred annuity contract is not a tax-avoidance device that needs "reform". Premiums paid for annuities are not deductible from gross income. Moreover, present-law rules do not forgive taxes on the investment earnings, they only provide for a deferral of tax. All income credited to the contract is taxed at ordinary rates when distributed to the contract owner.

- -- As in the case of life insurance contracts, taxing the inside build-up on annuity contracts would mean that policyholders would be taxed on amounts they have not received and cannot receive without giving up basic benefits.

B. Limit the Amount that a Policyholder May Invest on a Tax-Deferred Basis

- -- Limiting the amount of premiums that an individual may pay for an annuity contract and not be taxed currently on the income credited to the contract fails to recognize the different retirement needs for individuals. Such a proposal does not take into consideration individuals who live in high cost areas or who may have obligations that extend beyond their working years. Arbitrarily imposing a limit would force these individuals to either restrict their contributions, and thus face the possibility of not providing adequately for their retirement years, or pay tax on income they have not received.

- -- The statement contained in the options pamphlet suggesting that non-qualified annuities "circumvent important rules applicable to qualified plans" does not take into consideration the changes enacted by Congress just last year. The Tax Reform Act of 1986 provided that the inside build-up on corporate owned annuities would be subject to taxation, thus, ensuring that deferred annuity contracts could not be used, on a tax-deferred basis, to fund deferred compensation of employees outside the restrictions generally applicable to qualified plans.

Most importantly, neither proposal recognizes the unique characteristic of a deferred annuity contract that makes it one of the most suitable means of providing for an individual's retirement security. Unlike other vehicles, deferred annuities provide protection against the possibility of outliving one's financial resources. For sound social and tax policy reasons, Congress should continue to encourage a policy which assures financial security and independence after retirement.

EMPLOYEE BENEFITS

1. Group Health Insurance -- (Item II(D)(5)(a)(1) and (5))

Among the revenue options are proposals to limit the exclusion of employer-provided health coverage by (1) including in an employee's income employer contributions to a health plan to the extent that they exceed a specified cap; (2) including in an employee's income employer contributions to a health plan up to a specified floor; (3) including all or a portion of employer contributions to a health plan in an employee's wages but only for FICA and FUTA tax purposes; and (4) including all employer contributions to a health plan in the income of employees earning at least $60,000 annually.

We are unalterably opposed to any form of taxation of employer contributions to health benefit plans for the following reasons:

- -- At the very time when ways are being explored to expand the availability of health coverage for those currently uninsured, it would be counter productive to impose new taxes which would discourage the provision of health coverage. The issue of taxing group health insurance was extensively considered and rejected less than a year ago during the tax reform effort.

- -- The burden of a tax cap would fall unequally on workers depending upon where they work, their ages, and their occupations. Taxing group health insurance this way would discriminate against workers in high health care cost areas -- California and New York for example. A tax cap would also have a heavy impact on groups composed primarily of older workers or workers employed in high-risk or hazardous occupations, since higher health premiums must be paid for such groups. A cap would also place essential preventive health care in jeopardy since employers would be discouraged by the cap from making contributions for other than catastrophic coverage.

- -- The burden of a tax floor would hit millions of lower- and middle-income families. It would introduce a disincentive for employees to continue their health insurance coverage.

-- Limiting the proposal to only the FICA and FUTA taxes would not avoid the basic problems outlined above. Also, this approach would place the full burden of the tax on those low and moderate income families who are in greatest need of the coverage.

2. Group-Term Life -- (Item II(D)(5)(A)(2) and (5))

Among revenue options under consideration are suggestions for repealing the exclusion for the first $50,000 of employer provided group-term life insurance for income and/or payroll tax purposes. One proposal would repeal the exclusion only for individuals with incomes in excess of $60,000 per year. We oppose repeal of the $50,000 exclusion for either income or payroll tax purposes for the following reasons:

-- The tax exclusion for employer-provided group-term life insurance has been invaluable in encouraging employers to sponsor plans and employees to participate in those plans. At the end of 1985, 96% of all full-time workers employed by medium- and large-sized firms were covered by group-term life insurance. This coverage amounted to 42.3% of the life insurance in force in the United States.

-- In eliminating the $50,000 exclusion for group-term life insurance, Congress would be removing a benefit of importance to lower- and middle-income employees. It would be requiring the great majority of American workers to pay a new tax in order to keep their group life insurance protection in force. This could have a very detrimental effect on keeping this valuable financial protection in place.

-- Group-term life insurance may represent the only financial protection available for a survivor in the event of the untimely death of an employee. For example, in many cases, workers cannot medically qualify for individual life insurance or cannot qualify because of their occupation. The proportion of workers who are uninsurable for individual life insurance has been estimated to be as much as 10 percent. It is only through group underwriting that private insurance can provide protection for these persons.

-- Limiting the proposal to only the FICA and FUTA taxes would not avoid the basic problems outlined above. Also, this approach would place the full burden of the tax on those low and moderate income families who are in greatest need of the coverage.

LIFE INSURANCE COMPANY TAXES

1. Life Insurance Reserves -- (Item II(D)(13)(a))

Four different approaches are suggested for limiting the deduction presently allowed a life insurance company for additions to life insurance reserves. They include disallowing any reserve deduction, gearing the deduction to increases in cash value, requiring the use of a Federally mandated interest rate, and disallowing any reserve deduction in the alternative minimum tax.

None of these changes in the current reserve rules are warranted:

-- Some of these proposals obviously are based on the premise that the current levels of life insurance tax reserves are overly conservative (too high). This is wrong. In 1984, Congress carefully reviewed and substantially revised the tax rules governing reserves of life insurance companies. The new rules are far more stringent than the prior ones and assure that tax reserves will be lean.

Under the new law, to be recognized for tax purposes, reserves must not exceed the minimum levels required by the laws of a majority of the States. Moreover, the mandated reserve method produces reserves in early years substantially lower than the net level method which had been permitted under prior law. The new rules adopt the interest rates as well as the mortality standards prescribed by state regulators, which reflect the long-term nature of funds invested under life insurance contracts. One of the revenue options suggests that a Federally prescribed interest rate should be used, rather than the rate prevailing in the States. The rationale given is that such a federal rate is currently prescribed for discounting property and casualty insurance reserves. While in the 1986 Act it was necessary to prescribe a special Federal interest rate for these reserves because regulatory reserves are not discounted, this is not necessary for life insurance reserves. An appropriate rate already exists under State law and is adopted in existing tax law.

-- The result of not allowing any life insurance reserve deduction, or providing a deduction that is too low, would be irrationally harsh. It would place a life insurance company wholly or partially on the equivalent of a cash basis of accounting and, thus, would grossly mismatch income and expenses in the case of long-term liabilities assumed by life insurance companies. The result would be a current tax on gross premiums, rather than on net income like all other taxpayers.

-- The reserves and the cash values for a policy are not equivalents and they should not be interchanged for tax purposes. The reserve for a policy is the monetary measure of all of the life insurance company's obligations under the policy. The cash value is one of the benefits under the policy; i.e., it is the amount that will be paid to the policyholder as an equitable settlement if he or she surrenders the policy before the insured event. Some policies contain no cash value and the company need reserve only for the insurance obligation. On the other hand, even for policies with cash values, there are always benefits which are not reflected in the cash value but which must be reflected in reserves.

2. Capitalize Agents' Commissions -- (Item (D)(13)(g))

This revenue option would require the capitalization of insurance selling agents' commissions.

-- Agents' commissions are expenses that fall within the main stream ordinary income activity of a life or health insurance company. They clearly represent every day recurrent expenses directly related to the marketing and servicing of the products of that business -- insurance and annuity contracts. For many sound reasons, such expenses have historically been treated for tax purposes as period costs, i.e., costs which are currently deductible, even though they relate to the acquisition of a property interest. Similarly, for example, current deductibility is allowed for marketing expenses incurred by banks and securities' firms although the relationship with the customer may extend over a number of years.

-- Moreover, the deductibility of agents' commissions, along with other first-year acquisition expenses, have already been accounted for in the reserving process for tax purposes. Under the reserving method required by the tax code (CRVM), practically no reserve is established for the first year of a contract. This reflects the fact that the first year's premium is essentially used to satisfy the first year's expenses, including agents' commissions. To also require capitalization of commissions would create rather than correct a mismatch when combined with the reserve method required by the current law. At the very minimum, any requirement of capitalization must be accompanied by a change to allow reserving under the net level premium method.

-- The proposed capitalization of agents' commissions is not necessary to accomplish consistency with the treatment of property and casualty insurance companies. The reduced reserve deduction required of those companies by the Tax Reform Act of 1986 relates to unearned gross premium reserves which contain an element of expense loading. In the case of life insurance reserves under the CRVM method, the only reserve allowed in the first year is based on the net premium or pure cost of insurance. No gross premium income deferral occurs.

-- The current law requirement that a life insurance company's acquisition expenses must be amortized in computing one of the preference items under the alternative minimum tax, without an offsetting change in the reserve method, is equally wrong. This mistake should not be compounded in the regular tax computation.

OTHER INSURANCE RELATED PROVISIONS

1. Reduction in Tax Preferences or Additions to the Alternative Minimum Tax Base -- (Item II(D)(2) and (15))

Several revenue options involve specifying "preferences" that would receive less than full tax effect. Under one approach, they would be added to the minimum tax base. Under another, their tax effect for regular tax purposes would be reduced by a specified percentage.

-- These approaches, whether by way of the regular tax or the alternative minimum tax, cut across the existing income tax system avoiding and upsetting policy decisions established after exhaustive considerations. These policy decisions should be directly addressed; the need for revenues should not be used as an excuse for not doing so. Such "minimum tax" type of approaches represent arbitrary and uneven ways to raise revenue.

-- Increasing the preference percentage of the seriously flawed AMT book income adjustment item, as proposed would, as only one example, clearly compound the damage to any equitable or rational tax system.

2. Taxation of Life Insurance for Estate Tax Purposes -- (Item II(E)(3))

This revenue option provides for including, in the gross estate of a deceased individual, the proceeds of any life insurance policy payable directly or indirectly to a relative of such individual, even though the decedent does not own the policy.

-- Including the proceeds of an insurance policy in a decedent's estate, where the decedent has assigned all incidents of ownership to another person, would be inconsistent with historical and accepted concepts of estate tax law. An individual's estate is not taxed on property or income over which he/she has no right or control. Once the incidents of ownership of a life insurance policy are assigned, the decedent loses the right to change the beneficiary of the policy, to borrow against its cash surrender value, or to surrender or cancel it. Thus, the individual has given up important rights and benefits by assigning the insurance policy.

-- The Tax Reform Act of 1976 specifically limited the application of the gift in contemplation of death rule to transfers made within three years of death. The effect of the current proposal would be to prohibit an insured from ever transferring a life insurance policy without such transfer being considered a gift in contemplation of death. There is no reason why this rule should be so dramatically expanded with regard to only insurance and not to other classes of property.

-- In many cases, the decedent may have had little or no involvement with the purchase of the insurance. Including the policy proceeds in the insured's estate under such circumstances would be contrary to federal tax and state property law principles and could impose an unexpected financial burden on the insured's estate. Moreover, it may be unconstitutional on due process grounds.

-- The assignment of the incidents of ownership of an insurance policy does not avoid transfer taxes. The transaction is subject to the gift tax provisions and, if the insured continues to pay the premiums on the policy, those premiums would also be subject to the gift tax rules. The unified estate and gift tax rate schedule providing progressive rates based on cumulative lifetime and death transfers substantially reduces any disparity in treatment between such transfers.

3. Current Accrual of Market Discount Bonds -- (Item II(D)(6)(g))

This revenue option would require that market discount on bonds be accrued currently for tax purposes rather than at the time the bond is sold or redeemed.

-- The tax treatment of market discount bonds was extensively examined during the considerations leading to the Tax Reform Act of 1984. A comprehensive revision was enacted. At that time, the current accrual of market discount in income was considered and rejected. There is no good reason for reversing this decision. Achieving symmetry with the treatment of original issue discount on this relatively minor timing issue would require adding substantial complexity and cost to already overburdened business taxpayers and the IRS.

4. Withholding Tax on Interest Paid to Foreigners -- (Item II(D)(12)(c))

This proposal would impose a 5% withholding tax on United States source interest income due a foreigner not otherwise subject to the income tax of this country.

-- The taxation of such "portfolio interest" was extensively examined during the consideration of the Tax Reform Act of 1984. For good and sound policy reasons, the existing 30% withholding tax was repealed.

-- Most other countries do not impose similar withholding taxes. This fact has encouraged the free flow of investment dollars on an international basis and helped to stabilize marketplaces such as the Eurobond market. United States borrowers need free and equal access to such markets to raise required capital. The reimposition of a United States withholding tax would upset present balances and would generate very substantial pressure to provide new escape avenues by way of new treaties or other exceptions. Foreign investment dollars would tend to go elsewhere escalating the balance of payment problem, and the tax would tend to be self-defeating.

-- International financial markets need assurance of continued stability. The current serious problem involving Eurobonds acquired through international finance subsidiaries formed in the Netherland Antilles attests to the sensitivity and interdependent nature of such markets. Any revenue raised by this clearly inadvisable proposal could be expected to be at substantial economic cost.

5. Qualified Plan Loans Treated as Distributions -- (Item II)(D)(5)(b)(1))

This revenue option proposal would treat loans from a qualified plan as a distribution of plan benefits. Thus, all or part of any loan amount would be includible in income and, to the extent the loan represents a premature distribution of plan benefits, it would be subject to a 10% penalty tax.

-- The rules regarding loans from qualified plans were significantly tightened under TEFRA and further narrowed only a few months ago in the Tax Reform Act of 1986. The effect of these rules is to subject plan loans to stringent restrictions both as to amount and time of repayment. Thus, current law substantially restricts the ability to use loans to divert funds from retirement purposes. A complete prohibition is unnecessary.

-- The practical result of the revenue option will be to discourage many lower paid employees from contributing to pension plans. Lower income employees, who have limited discretionary funds, will be reluctant to commit funds to a qualified retirement plan if access to those funds is available only at the price of extremely adverse tax consequences.

-- While we agree that funds designated for retirement purposes should -- whenever possible -- be maintained intact, this is not always feasible when an employee faces an unanticipated financial need. While higher income employees are likely to have alternative borrowing options to meet such needs, for many of the lower paid a retirement plan is their only significant source of available funds.

TAX PARITY PROPOSALS -- (ITEM II(D)(13)(c)

In looking for new sources of revenue, the commercial life and health insurance industry would encourage the Committee to consider the revenue options that would eliminate preferential tax subsidies to businesses which compete for the same markets as our companies which do not receive such subsidies. These revenue options particularly address the tax treatment of Blue Cross and Blue Shield Plans and the current tax exemption granted many health maintenance organizations (HMOs).

July 23, 1987

COMMENTS CONCERNING LEGISLATIVE PROPOSALS
RELATING TO
PUBLICLY TRADED LIMITED PARTNERSHIPS

Submitted
By

APACHE CORPORATION

A number of proposals have been circulated concerning changes in certain aspects of the taxation of publicly traded limited partnerships ("PTLPs") if they continue to be taxed as partnerships rather than as coroprations. Set forth below is Apache's evaluation of these proposals.

Treatment of Net Income from PTLPs as Portfolio Income. It is unfair, as a matter of tax policy, to single out a particular type of partnership and treat all of its net income as portfolio income without regard to its activities. We see no reason why investors of modest financial means who invest in a PTLP engaged in oil and gas activities should be required to treat their income as portfolio income while investors of more substantial means who invest in a two or three member oil and gas limited partnership would be entitled to treat their income as passive and thus be able to use it to offset losses from other passive activities.

Treatment of Net Income from Publicly Offered Partnerships as Portfolio Income. Treatment of net income from all publicly offered partnerships as portfolio income would simply compound the unfairness by further penalizing small investors. If Congress wishes to confine the deductibility of losses to income from the activity that generates the losses, it should apply this principle to all taxpayers, not just to those who must invest in large publicly offered partnerships because they lack the financial means to invest in those offered to a small number of investors. We recognize that the revenue implications are greater with respect to publicly offered and publicly traded partnerships than with respect to private partnerships. However, Congress should concern itself with issues of fairness as well as of revenue when it makes fundamental changes in the tax laws.

Limitation on PTLP Debt. Limitation of the amount of debt that could be incurred by a PTLP would severely restrict flexibility of operation. The at-risk rules already limit the ability of limited investors to claim deductions attributable to partnership-level debt financing. Accordingly, the application of an "over-leveraging" formula (and penalties should such "over-leveraging" inadvertently occur) would greatly increase the complexity of administering PTLPs without any apparent or significant tax policy benefit. We do not understand why a leveraging restriction would be applied to PTLPs before being applied to corporations (where the policy implications of over-leveraging are more serious) other than for punitive reasons.

Amendment of UBTI Provisions. Income with respect to equity investments by tax-exempt entities in PTLPs is already generally subject to taxation as unrelated business taxable income ("UBTI"). The policy implications of extending the UBTI rules to tax debt instruments held by tax-exempt organizations are no different for PTLPs than for corporations. The rationale for taxing an equity investment by an exempt organization in a partnership as UBTI is to achieve neutrality between corporate and partnership investments, since income from corporate equity investments is subject to corporate level tax. The effect of debt financing is thus the same for both corporations and PTLPs (i.e., it eliminates tax at any level). Moreover, adopting a rule with respect to PTLPs without also applying it to corporations would severely disadvantage PTLPs in obtaining financing. We therefore believe that this issue should be addressed in the context of overall tax reform rather than PTLP tax reform.

Partnership Level Withholding. Withholding on partnership distributions would be far more complicated than withholding on dividends or interest because distributable income is not the same as taxable income. As a result, PTLPs would generally be forced to overwithhold (or withhold with respect to the wrong taxpayer where an investor has sold immediately before a distribution). This would diminish the marketability of interests because the primary investment motivation of PTLP investors is stream of income rather than appreciation in value. Information reporting applies to PTLP income as well as to dividends and interest. Therefore, in the absence of evidence that PTLP income is any more underreported than dividend or interest income, we do not believe that PTLP investors should be treated differently than other types of investors.

Partnership Level Deficiency Payment. Partnership level deficiency and refund payments would be beneficial, not only for PTLPs but for other types of partnerships. The partnership agreement could provide for allocation of benefits and burdens among partners and former partners. It might be advisable to make provision for direct assessments and refunds in the case of extraordinary deficiencies or overpayments.

Elimination of Section 754 Election. Elimination of the section 754 election would destroy the marketability of PTLP interests because it would result in the double taxation of gain. A selling investor is subject to tax on any gain from the sale of the interest. If the purchaser is denied an increase in the basis of partnership assets, the purchaser would be retaxed on the same gain if the partnership sold the assets. In addition, elimination of the section 754 election would reduce, rather than increase, the fungibility of PTLP interests and thereby increase the complexity of PTLP taxation.

Limitation to Passive Activities. Limitation of PTLPs to passive activities would be detrimental to the viability of the form of entity as a whole and would destroy the marketability of existing PTLPs. APC, the PTLP of which Apache is general partner, was formed to finance and engage in oil and gas production activities. Limiting APC and other oil and gas PTLPs to passive activities would have an adverse effect on financing U.S. oil and gas exploration, drilling and production.

Netting of Income and Loss. Netting of income and loss before flowing them through the partners would be difficult to achieve in an oil and gas partnership where depletion is determined at the partner level. In addition, it would not be possible in PTLPs which are required to make section 704(c) (or reverse section 704(c)) allocations.

Changes in AMT Treatment. Investors are already subject to AMT with respect to preference items flowed through from PTLPs. We do not believe any revenue to be gained from treating PTLPs as separate entities for AMT purposes (or in subjecting investors to the book income preference) would be of sufficient magnitude to compensate for the increased level of complexity that would result.

Changes in Allocation and Basis Adjustment Rules to Achieve Fungibility of Units. Changes in the tax rules governing allocations and basis adjustments to provide certainty with respect to allocations made to achieve fungibility of interests would be highly desirable. The present problems arise not because PTLPs are making distortive allocations to achieve fungibility but because literal application of existing regulations (which do not contemplate any situation more complicated than cash and a single item of either depreciable or nondepreciable property) would produce distortions in the tax relationship among the partners. We believe that the interest of Congress and the PTLPs is identical in this regard: an investor making a $1 after-tax investment should receive $1 of potential tax benefit while an investor making a $10 investment should receive $10 of benefit. An interpretation of the regulations to require that the $1 investor receive, say, $3 of potential benefits while the $10 investor receives $8 is not in the interest of sound tax policy and is subject to manipulation.

Modification of Constructive Termination Rules. A change in the constructive termination rules to permit PTLPs to disregard transfers by less than 5 percent interest holders would be desirable and would not undercut the purpose of the rule. Its purpose is to prevent manipulation of tax years. Such manipulation could not be achieved by individual investors trading on an exchange, particularly where, as is the case with most PTLPs, a calendar year is otherwise mandated under the Code. (We would not be opposed to requiring a calendar year for all PTLPs.)

Monthly Allocations. Permitting monthly allocation periods would go far toward achieving simplification in the taxation of PTLPs without presenting any significant opportunity for shifting of tax benefits and burdens among partners. We see no reason to diffentiate between income and loss in this regard. To safeguard against manipulation, regulations could require that income or loss from extraordinary realization events be allocated among the partners in accordance with their interests on the date the event occurs.

Nominee Reporting Penalty. Imposing a penalty on the failure to satisfy nominee reporting requirements would improve nominee reporting and therefore assist PTLPs in their efforts to achieve full reporting compliance. Quarterly reporting would also be desirable in that it would permit PTLPs to prepare for the distribution of tax information before year end.

Reconciliation of Sections 6045 and 6050K. We believe that the present exemption in the regulations under section 6050K for transactions subject to reporting by brokers under section 6045 should generally be retained. PTLPs should be required to supply the requisite section 751 information to investors but at the time they distribute K-1s instead of by the present January 31 deadline. They should also be permitted (for reasons of administrative cost) to include the information on the K-1s rather than provide it by separate statement or return.

Expansion of Tax Matters Partner's Settlement Authority. It would be beneficial to expand the tax matters partner's settlement authority to include all partners, particularly if partnership level deficiency and refund payments are permitted. Consideration might also be given to denying partners in PTLPs the right to opt out of settlement agreements unless they are part of a group representing a certain percentage (e.g., 5 percent) of interests.

Withholding with Respect to Foreign Partners. We support efforts to simplify withholding requirements with respect to foreign partners although this issue is not of direct concern to APC because it does not permit foreign partners due to its federal oil and gas leases.

Statement of
Association for Advanced Life Underwriting
Presented on
Revenue Increase Options
Committee on Ways and Means
United States House of Representatives
July 15, 1987

The Association for Advanced Life Underwriting (AALU) is a nationwide organization of life insurance agents and others engaged in the use of life insurance and related products in the fields of business continuation planning, estate planning, retirement plans and employee benefits. This statement is submitted on behalf of our members and, more significantly, on behalf of our millions of policyholders who rely upon the protection they receive from billions of dollars of life insurance coverage. We believe we can accurately convey to the Committee the response that can be expected from our policyholders once the full impact of the Joint Committee's options is understood by the country.

We support and adopt the statements of the National Association of Life Underwriters and the American Council of Life Insurance and look specifically to the latter organization for leadership in matters that affect life insurance company taxation.

A. General Comments.

This statement will set forth AALU's comments on those of the Joint Committee's possible options to increased revenues which will have particular impact on the life insurance industry and the people it serves. We are most concerned with the fact that implementation of one or more of these options is part of a process which, no matter how important in terms of Federal budgetary considerations, is simply ill suited to the implementation of complex, technical tax proposals requiring intense and often lengthy review. Furthermore, the tolerance of the public is, we fear, wearing exceedingly thin for constant and often chaotic changes in our Revenue laws.

1. We Are Enmeshed In An Unacceptable Continuum of Detrimentally Repetitive Tax Legislation.

The current proposals appear to be part of an ongoing system of enactments and reenactments of major tax legislation on virtually an annual basis throughout the last half decade or so. Major tax reform legislation has been enacted in 1981, 1982, 1984 and 1986. It appears that 1987 is to be next. Thus, if we do have a major change in the tax code this year, it will constitute the fifth such change in the past seven years.

This sequence of excessive and sometimes contradictory tax legislation cannot help but cause public disrespect for the taxing system and the legislative process which produces that system. Outrage is not too strong a word to use to describe the expected public response to revenue law changes that come at a rate that overwhelms the taxpayer's ability to absorb them. Our government is one of laws and not of men; however, this government of laws is designed for men who, if they cannot understand those laws, cannot be expected effectively to interpret or use them.

It is difficult enough for tax professionals to maintain a semblance of understanding of this continually changing Revenue Code; it is literally impossible for the public to do so. The Revenue Service, itself, falls prey to this problem, being well behind in the promulgation of regulations for Revenue Code sections whose lifetimes often barely exceed infancy. It is simply unreasonable for the Congress to anticipate that the country will be able to conform its conduct to confusing, changing rules before the Revenue Service, the ultimate expert in these matters, can finally decide what it thinks these new rules mean.

This constant process of tax change breeds public confusion and antipathy to the entire legislative process. It also prevents business from planning meaningful and responsible future courses of action. Further, as we have noted, it causes an inability on the part of the Revenue Service to administer the system in an equitable and efficient fashion. We do not overstate the case when we suggest that the Congress is now running the risk of generating an anarchic and total unmanageable public response to our tax legislative process.

2. The Budget Reconciliation Process Is An Inappropriate Means Of Effecting Major Changes In Technical Tax Matters.

The budget reconciliation process, as it is now structured, is inconsistent with the development of a rational approach to tax legislation. That process produces unnecessarily rigid time limitations and provides inadequate opportunity for review of technical issues. A substantially longer lead time for that review should be provided. It is clearly inadequate to commence the tax portion of the process on June 26 through a Ways and Means Committee press release and to conclude the initial phase of public opportunity for input in the House less than three weeks later on the following July 15, particularly in light of the recently-enacted 1986 Tax Reform Act and the statements of leading Congressional spokesmen that additional substantive tax reform would not be addressed in 1987.

We are mindful that Federal budgetary matters are of extreme importance and should be addressed promptly by the Congress. However, the budgetary process is a blunt macroeconomic tool designed not only to regulate the Federal governmental process, but also to impact in a directed manner the response of our national economy. It is ill suited to the intricate and often minute analysis which is necessary as a precondition to meaningful tax legislation. This is particularly true of tax system potential changes which are of a relatively minor budgetary impact considering the large dollar numbers with which we are working. It is vastly preferable to make one or two or three major tax system changes (e.g., tax rate changes, new or expanded excise taxes) which on a cumulative basis will attain the dollar goal--in this case $65 billion--than to accumulate a series of smaller changes which by their very nature require significant and time-consuming analyses.

The proposed changes we are addressing in this statement are of the smaller variety in budget number terms and should not be pressured to passage by the budget reconciliation process. If we permit that process to overrun the tax process, we will only feed the public outrage that is being generated by the unacceptable speed of tax legislative change referenced above.

While we would object to many of the proposed options, we will focus in this statement on three general categories which are of particular concern to the life insurance industry --life insurance and annuity policyholder issues, estate and gift issues and retirement benefit issues.

B. Life Insurance and Annuities.

Among the suggestions appearing primarily on pages 221 through 227 of the Joint Committee Option Paper are the following, all of which would have unacceptable, adverse impact on our private life insurance system:

a. Tax the so-called inside buildup.
b. Include the inside buildup as a preference in the alternative minimum tax base.
c. Tax policy distributions on a LIFO basis.
d. Treat life insurance policy loans as LIFO distributions.
e. Narrow the definition of life insurance, ostensibly for the purpose of excluding allegedly investment heavy products.
f. Apply imputed income rules to life insurance loans on a net basis.
g. Tax annuities in the hands of individuals on the accrual basis applicable to corporations.

Since many of the reasons why the above proposals are inappropriate apply to all of them, we will set forth our discussion as generally applicable to all the proposals. It should be clear from the context of our discussion when we are considering a specific option and when we are proposing analyses which apply to more than one, perhaps in some cases to all, of the options.

We recognize that in recent months attention has been directed to certain marketing techniques involving single premium life insurance. Those techniques, which often utilized overly-aggressive promotional and advertising claims, have raised questions concerning the adequacy of the current tax treatment of single premium policies. That subject will not be treated directly in this paper, partially because it entails a degree of complexity requiring a broader time period than that available for the preparation of this paper, but more importantly because we understand that the issue will be examined, perhaps later this year or early next year, in a detailed review of the effect of recent tax legislative changes as applicable to the life insurance industry.

We acknowledge that the questions raised about single premium life insurance are serious ones which deserve Congressional attention. The answers to those questions, however, should not be pre-judged in a process in which there may not be sufficient time to make the appropriate analyses; otherwise, unnecessary damage to the legitimate uses of single premium and other forms of life insurance could easily result.

1. The Current Approach To the Taxation of Life Insurance Policyholders Is Appropriate In Implementation of the Social Policy of Encouraging Death Benefits.

Since the commencement of the application of formal Revenue Code rules to life insurance, the accumulation of life insurance policy cash values has not been subjected to tax. Alternatively, the receipt of dividends by owners of traditional participating policies and of withdrawals by owners of universal life policies (herein such dividends and withdrawals being collectively called distributions) has been taxed to policyholders. However, that tax has been imposed only after recoupment by the recipients of their full basis in the policy. In addition, policy loan proceeds have never been treated for tax purposes as policy distributions subject to tax.

This long-standing series of tax rules reflects a sound legislative judgment which has been reached over and over again as the tax treatment of the life insurance industry and life insurance policies has been reexamined by the Congress. The existing system of life insurance taxation encourages, perhaps more accurately, makes it possible to have, a viable private death benefit structure. The Congress has repeatedly agreed that a life insurance system which, in contrast to other forms of savings, is specifically designed to protect beneficiaries (whether individuals, trusts or business entities) following a death--usually of the family breadwinner--is of sufficient importance to warrant strong encouragement by the taxing system.

2. The Current Approach To the Taxation of Life Insurance Policyholders Is Totally Consistent With Generally Applicable Principles of Taxation.

The option which would impose a tax on so-called inside buildup ignores the fact that such a tax would be imposed even though the policyholder had neither actually nor constructively received that buildup. Furthermore, the policyholder would not in any event have access to the inside buildup without incurring a real and burdensome cost.

For example, if he were to receive a distribution from the policy he would be relinquishing the benefit of having the amount of that distribution remain in the policy to support greater future death benefits or lower future costs. In fact, the current method of taxing distributions from life insurance policies is an acknowledgement that such a distribution is an adjustment of death benefit cost to be applied first against policy basis.

Where a distribution results in the direct reduction of policy death benefits, it is patent that such a distribution entails a real cost to the policyholder and is not a form of income return. Where there is no direct reduction in death benefit as the result of a distribution, there will inevitably be increases in future policy premiums either directly, as is typical of universal life policies, or through future dividend adjustments, the approach which is more typical of traditional participating policies.

Thus, in either event a policy distribution involves trade-offs, the presence of which make it inequitable to impose a tax prior to the receipt of that distribution (i.e., on the cash value accumulation) or on the receipt of that distribution until after all basis recovery has been effected.

That inequity is no less present where the tax on the inside buildup takes the form of a so-called preference tax, whether through an alternative minimum tax approach or through a specific impost on a defined class of preferences. The principles that lead to rejection of the options that would impose a direct tax on life insurance policyholders are equally applicable to these indirect forms of taxation.

3. Loans Are Not And Should Not Be Treated Like Policy Distributions.

Borrowing against the security of insurance cash values entails, even more so than policy distributions, major costs to the policyholder in that a policy encumbered with a loan has a lower net death benefit. In addition, the policyholder is forced to pay an interest cost, as in the case of any arm's length loan, and must, on or before termination or maturity of the policy, repay that loan and remove the encumbrance.

That interest is nondeductible pursuant to standard personal or investment interest rules. The deductibility of that interest is specially limited in many business situations by an amendment enacted in 1986 to section 264 of the Code which unfairly discriminates against life insurance versus all other business property. That special business deduction disallowance is predicated upon the nontaxability of the inside buildup. Imposing a tax on policy loan proceeds would be inconsistent with the 1986 amendment to section 264 and would constitute a punitive attack on life insurance.

Furthermore, the degree of reliance policyholders have placed on access to policy cash values through loans cannot be overemphasized. Any effort to cut off that access for existing policies would not only be inequitable, but would surely be met with outrage from our policyholders. That response can be expected particularly from older people who traditionally rely on loans against their policies to cover a multiplicity of legitimate needs. Insurance borrowers are burdened with a meaningful interest cost; an unnecessary tax cost should not be added to that burden.

4. Congress Has Repeatedly Rejected Changes In Life Insurance Taxation Identical or Similar To Those Proposed In The Option Paper.

Starting in 1983, with the so-called Stark-Moore hearings in the Ways and Means Committee and following through other similar hearings in that Committee and in the Senate Finance Committee, the taxation of life insurance at the company and policy levels has been reexamined by the Congress in almost excruciating repetition and detail. Proposals to tax the inside buildup, policy distributions and policy loans were considered and rejected.

Substantially less than a year has passed since enactment of the 1986 Tax Reform Act and we have not had even one full taxable year of experience under the provisions of that enactment. Some reasonable time to assess the success of that Act is surely warranted. Furthermore, to make any change in the treatment of policy taxation in the period of a few weeks with no meaningful opportunity for examination of the substantive issues would be unjustifiable in light of the rejection of any such changes after reexamination of the same areas over the prior four year period.

5. The Life Insurance Definition Is Operating As Intended And Should Not Be Changed.

The proposal to change the definition of a life insurance policy is inappropriate for many of the reasons stated above.

Revenue Code section 7702, which sets forth a rather detailed definition of life insurance and which was enacted initially in 1984 as an expansion of the then two year old section 101(f), is the result of a careful process of study culminating in the adoption of specific standards respecting the investment component of a life insurance policy. That section contains intricate rules which measure the permissible premium and cash value accumulations in a policy relative to death benefit. Those standards were enacted specifically to measure the degree to which advance funding is necessary and appropriate in order to guarantee identified levels of whole life death benefits.

There has been no showing that these standards are incorrect. Furthermore, the subject is of such complexity that it would be impossible to engage in a review of those standards within the time frame mandated by the budget reconciliation process.

6. Corporate Annuity Taxation Principles Should Not Be Extended To Individually Owned Annuities.

The Congress was not well advised when last year it extended an accrual basis form of taxation to corporate owned annuities. It should not compound that error by now applying that approach to individually owned annuities.

The retirement benefit function of the annuity policy, whether held directly by an individual or serving as the funding medium for a corporately paid retirement benefit, is undermined by the imposition of the tax prior to the receipt of benefits under the policy.

C. Estate Tax Imposition on Life Insurance.

The Joint Committee Option Paper proposes a sequence of options by which revenues could presumably be extracted from the estate and gift tax system.

We can appreciate that in a revenue driven reexamination one might consider the efficacy of generally applicable changes, such as rate changes and basis step-up amendments. We are, however, at a loss to understand the equity of a change which proposes that life insurance--in contrast to all other forms of property--may not be passed on to family members at death free of an estate tax. That is precisely what the option paper suggests when it proposes on page 261 that a life insurance policy payable to a relative of the insured will be included in the insured's gross estate irrespective of the insured's incidents of ownership to that policy.

Such a proposal is plainly discriminatory to life insurance policies. For example, an individual can buy a share of stock on margin, transfer that share to his child subject to the margin account and continue periodically to pay amounts that will be applied against the margin account. The payments of the periodic installments of the purchase price would constitute gift transfers subject to the imposition of gift tax if warranted under general gift tax rules. However, at the time of death the then value of the share of stock would not be included in the decedent's estate. This is analogous to what happens currently with respect to life insurance. If the insured transfers the policy by gift, the gift tax rules apply at the time of each premium payment. The transfer tax system, having extracted such tax as may be due during life, does not impose a tax at death.

The reasons given in the Joint Committee pamphlet in support of this option of increasing the estate tax on life insurance fall far short of a satisfactory explanation for the proposal. The pamphlet states that,

> "an individual may take out a life insurance policy, irrevocably designate beneficiaries of the policy, and transfer all incidents of ownership to another person. In that situation, the proceeds of the life insurance policy are not includible in the decedent's gross estate even if the decedent pays all policy premiums. Such an arrangement effectively transfers the property at death while avoiding estate tax." (Emphasis supplied.)

Let us suggest the redrafting of that quote, substituting a share of stock for life insurance policy.

> "An individual may purchase a share of stock, irrevocably designate new beneficial owners of that stock, and transfer all incidents of ownership to another person. In that situation the value of the share of stock is not includible in the decedent's gross estate, even if decedent pays the entire purchase price of the share. Such an arrangement effectively transfers property at death while avoiding estate tax." (Emphasis supplied.)

Clearly life insurance should not be treated differently from the share of stock for estate tax purposes.

The second reason given in the Joint Committee pamphlet is that, "life insurance is inherently a death time transfer. Adoption of the proposal would ensure that all transfers at death are subject to estate tax."

Life insurance is inherently a death time transfer if it is owned at the time of death. If it is cashed in prior to death, it is no more inherently a death time transfer than any other property. Furthermore, at the time of such cashing in income tax would be paid to the extent that the cash value exceeds basis. Likewise the ownership of a share of stock is inherently a death time transfer if that share of stock is owned at death. Adoption of this proposal for shares of stock would ensure that all transfers at death of such shares of stock are subject to estate tax.

The drafters of this option may feel that life insurance is not now appropriately taxed under the estate tax system as compared to other forms of property. However, they simply have not provided a satisfactory reason to support that feeling. Furthermore, they have not taken into account that, unlike many other forms of property, a life insurance policy (or premium in connection therewith) which is transferred within three years of death, does not escape inclusion, in whole or in part, in the gross estate. The option paper's insinuation that life insurance currently is for the most part beyond the scope of the estate tax system is simply unwarranted.

This seeming animus towards life insurance is also reflected in the limitations proposed on page 269 of the Option Paper to utilization of gift tax present interest generating Crummey powers by permitting validation of only so-called "hanging" Crummey powers. This proposal, if adopted, virtually guarantees additional limitations on the use of life insurance trusts. It is very difficult, if not impossible for a trustee to commit monies to a continuing investment in a life insurance policy where he will be subject, year after year, to Crummey power invasion and termination of the policy.

Investment in a life insurance policy requires reasonable assurances of permanency and continuity. Those assurances will not be possible if the Congress mandates that the Crummey power must be present indefinitely. This proposal, in common with the option directly respecting the estate tax treatment of life insurance policies, should be rejected.

Lastly, we strongly challenge the wisdom and the public policy support for proposals which would tend to deprive small businesses and family farms of the major source of the liquidity necesary to ensure family ownership continuity. There is something intrinsically wrong with proposals that have such an effect.

D. Pension and Employee Benefit Provisions.

In recent years Congress has raised substantial revenue from pensions and employee benefits--particularly tempting targets because of the substantial assets held for the retirement security of employees and other taxpayers. We urge Congress to avoid the tendency to raise further revenue from this "easy target." Valuable protections would be lost and the retirement security of millions of Americans would be jeopardized.

Considerable sentiment was exhibited in Congress at the time of the passage of the Tax Reform Act of 1986 for avoiding further changes in pensions and employee benefits. Many Congressmen voiced concern that Congress was too frequently amending the rules and causing disruptions in long-term planning. This sentiment was reflected in provisions that delayed for several years the need to make plan amendments. Again, Congress is facing revenue concerns and may be seduced to make changes that will disrupt long-term planning. It should, however, resist that temptation and avoid further changes so that the area can stabilize and employers can once again develop long-term plans. In fact, we would urge Congress to put aside any pension changes pending the development of a rational, fair, efficient and badly needed national pension policy by which we can equitably ensure our taxpayers a satisfactory degree of retirement security.

Five of the pension/employee benefit proposals in the Joint Committee staff options require special comment.

1. Five Percent Excise Tax on Net Investment Income.

One of the proposals would impose a five percent excise tax on the net investment income of all tax-exempt organizations, including section 401(a) qualified pension or profit sharing plans. Clearly the proposal will raise revenue. However, it will do so by directly diminishing the assets available for employees' retirement. This contradicts our established national goal of providing retirement income security through pension and profit sharing plans.

Further, it seems highly unlikely that employers would offset this new tax through increased contributions. Employers generally establish their rates of contribution with respect to how much they can effort to put into the plan and it would be unreasonable to assume an increased contribution from employers to offset this tax. To the extent that employers do increase their contribution, however, there would be, through increased contribution deductions, a reduction in the revenue gains to be achieved from the proposal.

In addition, employees provide for their retirements through three sources: (1) personal savings; (2) pension and profit sharing plans and (3) social security. None of the revenue options is designed to or would enhance personal savings. In fact, the options are designed to raise revenues and reduce personal savings. Consequently, since the funds available through the pension and profit sharing plans would be reduced, either the individuals will suffer lower income in retirement or social security will be inevitably forced to pick up the burden of replacing these lost funds. Enacting an excise tax that eventually leads to increased funding for social security appears inadvisable.

Finally, imposing this excise tax on plans would increase already substantial administrative and filing burdens which should, if anything, be reduced.

2. Repeal of Exclusion for Group Term Life Insurance.

The staff options include two proposals dealing with the income tax exclusion for the first $50,000 of group term life insurance coverage. The first proposal suggests a repeal of the exclusion for all employees, and the second proposal suggests that only high-income individuals would lose the income tax exclusion.

The exclusion from income (and social security wages) of the first $50,000 of group term life insurance provided by an employer has been a mainstay of the tax law for many years. The exclusion has not been increased with inflation and has in fact diminished greatly (in terms of purchasing value). Further, explicit nondiscrimination rules, similar to those required for qualified plans, are imposed so that a group term life insurance plan must provide coverage to both low and moderate income employees. Repeal of the income tax exclusion would doubtless result in a substantial decline in the amount of group term life insurance provided to those employees.

In many cases, the only life insurance protection maintained for an employee is through the group term life insurance plan of the employer. Provision of life insurance protection to employees is a worthwhile social goal that is well justified by the revenue required to maintain this incentive.

3. Taxation of Qualified Plan Loans.

One of the proposals would treat all loans from qualified plans as taxable distributions (to the extent that any distribution would be taxable). Since this proposed change does not, according to the estimates, gain much revenue, its inclusion must be justified primarily on policy grounds. Those grounds, the Joint Committee staff suggests, are that it may enhance retirement savings to make all plan loans taxable and that it is appropriate to treat plan loans in the same way that loans from individual retirement accounts are treated.

Neither of these propositions is correct.

Taxation of plan loans would, as a practical matter, mean that plans would no longer make loans to participants. As a result, any revenue gain from this proposal is unlikely.

Taxing or preventing loans to an employee from a plan (loans from other sources, such as a bank, are not taxable) is discriminatory since retirement savings may be the principal financial asset of a lower income employee. Since these retirement savings cannot be assigned as security for a loan from a third party, the only potential source of borrowing for that individual may be the plan itself. In contrast, a higher income employee will likely be able to borrow elsewhere.

The Joint Committee staff suggests that qualified plan loans will reduce the income available to an employee at retirement. This statement is wrong on two counts. First, it overlooks the explicit provisions of current law, which require that loans be repaid within five years (except for home loans). Therefore the funds will be repaid and will be available to the individual at retirement. Second, loans enhance the attractiveness of qualified plans for employees. This elimination will further reduce the incentive to provide retirement plans.

Finally, comparison with an IRA appears unjustified. IRAs are maintained by an individual for himself. Qualified plans are maintained by third-party administrators for employees generally. As such, the third-party administrators are ensuring that the plan complies with all repayment requirements. Substantial differences between IRAs and qualified retirement plans justify a difference in the tax treatment of loans.

4. Reduction in Full Funding Limitation.

Under current law, employers make deductible contributions within limits to fund defined benefit retirement plans. One of those limitations is referred to as the full funding limitation, i.e., the amount of assets necessary to fully fund the plan based on the projected benefits that will be provided by it. Projected benefits are used because pension plans are ongoing plans. In fact, the plans are required to be "permanent" as a necessary condition of their qualified status.

One of the staff proposals is that the full funding limitation be reduced by recalculating the limitation based on a plan's termination liability, rather than its projected benefits. The assumption is that the plan is likely to be terminated in the near future and that a lower amount of assets will be required to meet the full funding limitation.

This proposal should be rejected because it undermines one of the important mainstays of defined benefit pension plans. The Administration and members of Congress have offered many legislative proposals designed to improve the funding of defined benefit plans to ensure that adequate benefits will be available to employees on retirement. The proposal to restrict the full funding limitation is contrary to that goal.

The short-term tax needs for revenue should not undermine the retirement security of employees. This option would, unfortunately, do just that.

CHESTER G. ATKINS
5TH DISTRICT, MASSACHUSETTS

COMMITTEES:
BUDGET
EDUCATION AND LABOR
FOREIGN AFFAIRS
STANDARDS OF OFFICIAL CONDUCT

LINDA J. HARTKE
ADMINISTRATIVE ASSISTANT

Congress of the United States
House of Representatives
Washington, DC 20515

REPLY TO
☐ WASHINGTON OFFICE:
504 CANNON BUILDING
WASHINGTON, DC 20515-9998
(202) 225-3411
☐ DISTRICT OFFICE:
134 MIDDLE STREET, SUITE 310
LOWELL, MA 01852-1886
(617) 459-0101
Toll free (800) 831-3125

July 17, 1987

Honorable Dan Rostenkowski, Chairman
Committee on Ways and Means
1102 Longworth House Office Building
Washington, DC 20515

Dear Chairman Rostenkowski:

I welcome this opportunity to comment on HR 2636, the Technical Corrections Act.

In taking action to reduce the federal budget deficit, the Congress determined that approximately $19 billion in new revenues would be needed. While raising taxes is certain to be controversial, it is the responsible way to reduce the deficit. Unlike the President, we Democrats in Congress have moved beyond rhetoric about the deficit; we have rolled up our sleeves and gone to work on it.

However, revenues must not be gained at the expense of the newly reformed tax structure. Last Fall, we made a promise to the American people that tax rates would be lowered and loopholes cut out. We cannot violate this promise less than one year later. As such, I would oppose a freeze or a change in the personal income tax rate structure.

Furthermore, we must be gentle with the economy. We must not discourage investment. If we are to tax consumption, it should only be those types of consumption that have negative social costs, or at least those without positive social benefits. Choosing from the "menu" compiled by your staff, I would, for example, favor the following items:

[1] 10% tax on luxury items, including furs; autos valued at more than $20,000; boats and yachts valued at more than $10,000; and jewelry and precious gemstones valued at more than $1,000. Thus, taxes would be levied on products that are neither essential nor customarily used by low-income taxpayers.

[2] Triple tobacco excise tax rates. Tobacco smoke is harmful to the health of users and non-users alike, and, lacking redeeming qualities, should be subject to extraordinary taxes.

[3] Pollution taxes on sulfur and nitrogen emmisions and on other ozone-depleting chemicals. This would create an incentive for industries to monitor themselves on environmental standards.

[4] Double tax on firearms. These tax rates have not been raised since 1955. The additional revenues could be directly dedicated to deficit reduction. Raising the tax will serve as an excellent mechanism for making handguns less available.

[5] Farms: remove cash accounting loophole for farms with income over $5-million per year, and treat farm losses like real estate losses under passive loss rules. In this time of great difficulties for family farms, it is not appropriate to offer a loophole to large agribusinesses.

[6] Natural resources: close expensing of intangible drilling costs loophole for large, integrated producers. It is inappropriate for the oil industry to be able to expense equipment inventories when other industries must capitalize.

I believe that these items can serve to raise revenue without damaging the economy, discouraging investment, or hurting the poor and middle-class. Again, I would emphasize my opposition to a postponement in the reduction of the personal income tax rates. Congress, in enacting a major new tax system, entered into a compact with the American people and it would be unwise to casually break a trust without first exhausting other means of raising revenue.

I hope that you find my commentary useful. With warm regards, I remain,

Sincerely yours,

Chet Atkins

Chester G. Atkins
Member of Congress

CGA:jcw

CITY OF BALTIMORE
CLARENCE "DU" BURNS, Mayor

DEPARTMENT OF EDUCATION
ALICE G. PINDERHUGHES
Superintendent of Public Instruction
3 East 25th Street
Baltimore, Maryland 21218

July 17, 1987

Honorable Congressman Dan Rostenkowski
Chairman, House, Ways and Means Committee
2111 Rayburn House Office Building
South Capital Street & Independence Ave. SE
Washington, D.C. 20515

Dear Congressman Rostenkowski:

I am writing to you in your capacity as Chairman of the House, Ways and Means Committee. The budgets of large urban school systems such as Baltimore and Chicago would be seriously harmed by adoption of some of the options currently being considered to raise the $19.3 billion in new revenue needed to meet the Congressional budget resolution of Fiscal Year 1988. We recommend that the needed revenues be raised without use of the following options:

- A medicare tax for State and Local Government Employees
- Repealing of exemptions from the motor fuels excise tax presently provided to State and Local governments
- Extension of the 3% telephone excise tax
- Raising taxes on gasoline
- Adding a 3% tax on energy consumption
- Taxing domestic or imported oil.

We believe that other options under consideration are more appropriate and would be less devastating to school system budgets. We hope that you will use your good offices to ensure that such undue hardships do not occur. Thank you for your assistance in this matter.

Sincerely,

Juanita Lewis, Ed.D.
Director of Legislative Affairs

jw

California Farm Bureau Federation
1601 Exposition Boulevard
Sacramento, California 95815
Phone: (916) 924-4075

July 15, 1987

A FARM BUREAU SPEEDLINE MESSAGE FOR:

The Honorable Dan Rostenkowski, Chairman
House Ways and Means Committee
U.S. House of Representatives
Washington, D.C. 20515

Dear Representative Rostenkowski:

On behalf of the more than 100,000 producer members of the California Farm Bureau Federation, I would like to comment on the revenue-raising proposals before the Senate Finance Committee. Farm Bureau policy opposes using new taxes to make up budgetary shortfalls; rather fair and equal across-the-board cuts in all programs and agencies should be made.

Several of the options being considered by the Committee will especially impact our members, i.e., increases in excise taxes on wine and beer, changes in estate taxes and increases in gasoline and fuel taxes.

An excise tax increase is highly selective and regressive. A Congressional Budget Office study shows that a 50 cent increase in the tax on a bottle of wine, along with other proposed increases in cigarette taxes and telephone taxes, would cost families earning less than $10,000 a year more than 2.5 percent of their income. Such regressive incidence is not in spirit with tax reform and the fairness of the gains made last year.

We find the proposal to increase the federal excise tax on wine especially objectionable since it is estimated that every 10 cent increase in the tax per gallon of wine will cost the grower as much as $100 per acre when wineries pass back their increased marketing costs. Winegrape growers are just beginning to recover after six years of sluggish growth and sales. To add to their costs now jeopardizes that growth, encourages imports, and increases the wine trade deficit, something that had narrowed considerably in the last several years.

Farmers and ranchers could be among the hardest hit by the capital gains and estate taxation proposals. The farm community depends on an orderly transfer of assets at death in order to continue production activities. Taxing an heir based on the carryover value of the property inherited and taxing at time of death, rather than at time of sale, greatly increases a grower's tax bill (liability). This huge lump payment greatly jeopardizes that orderly transition, as well as the fragile recovery that we have seen in the farm sector over the past three years.

Excise tax increases run contrary to the Tax Reform Act of 1986. The object of tax reform was to achieve lower and simpler taxes, not to arbitrarily raise taxes. In short, we believe that the only equitable way to balance the federal budget is to limit spending through further across-the-board cuts, not to resort to additional taxes on farm commodities and families.

Sincerely,

Henry J. Voss
President

City of Canandaigua
Canandaigua, New York 14424

RICHARD D. MC GAVERN
MAYOR

July 20, 1987

Honorable Daniel Rostenkowski
Ways and Means Chairman
House Ways and Means Committee
Capitol Building
Washington, D.C. 20027

Subj: General Aviation
Ten Percent Luxery Tax
Ten Cent Per Gallon Additional Aviation Fuel
Tax - Legislation Pending

Dear Chairman Rostenkowski,

We feel general aviation is very important to the operation of not only our local government but also our business.

Deregulation has brought us lower levels of service. Many of our key elected officials are full-time participants in the job force. Without general aviation they would not have any time to devote to local government.

General aviation is not a luxury but a necessity. Please consider your additional taxes very carefully. Hopefully, they will not be voted in.

Very truly yours,

Richard D. McGavern
Mayor City of Canandaigua
RDM-bd

Statement of Eley C. Frazer, III on Behalf of the Forest Industries Committee on Timber Valuation and Taxation

I. INTRODUCTION

This statement is presented by the Forest Industries Committee on Timber Valuation and Taxation on behalf of the 7 million private timber owners. In addition, for purposes of this testimony, we also represent over 60 forest related associations, including the American Paper Institute, American Plywood Association, Forest Farmers Association, Industrial Forestry Association, National Forest Products Association, and Southern Forest Products Association. A list of these associations is attached as Appendix A.

The Forest Industries Committee's members include timberland owners of all sizes from all timber producing regions of the country, from small tract owners and forest farmers to the largest of the integrated forest products enterprises. Our industry is easily the least concentrated of the resource-based industries. Approximately 80 percent of the privately-held commercial forest acreage is in the hands of non-industrial owners.

There is unanimity among all sectors of the industry that federal tax policy is an important determinant of the quantity of timber that will be available for harvest in future years, as well as the extent to which the timber resources will be managed for higher productivity. This in turn directly influences the creation and preservation of jobs in those geographic areas of the country dependent upon a healthy timber industry. Similarly, tax policy affects the extent to which forest products exports can continue to be a major contributor to our nation's balance of payments.

II. ENSURING TIMBER SUPPLY: A NATIONAL GOAL

We believe that ensuring an adequate timber supply is a vital national goal.

A. Our Nation's Future Timber Needs Are Increasing

The United States Forest Service estimates that domestic demand for paper and wood products may double by the year 2030, with the demand for paper and wood products climbing from 13.4 billion cubic feet in 1976 to 28.3 billion cubic feet in 2030. Table I summarizes the projected supply/demand situation:

Table I

Summary of U.S. Supply and Demand for Timber in 1976 and 2030 1/

Category	Billion Cubic Feet 1976	2030
Total U.S. demand	13.4	28.3
Exports	1.8	1.3
Imports	2.8	4.5
Demand on U.S. forests	12.4	25.1
Supply from U.S. forests	12.4	21.2
Supply/demand imbalance	0.0	-3.9

Source: U.S. Forest Service.

To meet the nation's future timber needs, high levels of reforestation and forestry investment must be encouraged. Unlike mistakes in other areas of tax policy that can be corrected with minimal long-term effects, adverse changes in timber tax policy will directly result in lost timber growth, an irreversible loss even with modern forestry technology. A tree not planted today is wood supply lost forever.

B. Importance of Timber Growing to the National Economy

Over 5,000 consumer products are derived from our forests -- products which are essential to education, communication, sanitation and health and many of which contribute in unique ways to the maintenance of the American standard of

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1/ The United States Forest Service ("USFS") has considered three alternative economic and demographic scenarios for its estimates. Based on these scenarios, the USFS has developed three alternative possible future demand levels: low-level demand, medium-level demand, and high-level demand. The data presented in this testimony depicts the results that will ensue assuming that medium-level demand were to occur.

living. A side benefit is that growing forests contributes significantly to the overall ecosystem, enhancing watersheds, wildlife habitants and stability for soils, while at the same time creating incomparable opportunities for recreation and scenic enjoyment.

U.S. Forest Service statistics have shown that every dollar of timber management results in a total of nearly $17 being generated in overall economic activity. This fact is illustrated in Table II.

TABLE II

Estimated value added and employment
attributable to timber
in timber-based economic activities, 1972

Economic Activity	Value Added (MMM$) Attributed to timber	(Employment MM People Attributed to timber
Timber management	2.9	0.1
Harvesting	3.1	0.2
Primary manufacturing	8.8	0.4
Transportation and marketing	9.3	0.8
Secondary manufacturing	12.5	0.9
Construction	11.9	0.8
Total	48.5	3.2

Source: U.S. Forest Service.

The reference to "timber management" in Table II indicates that the value of timber harvested in 1972 was $2.9 billion on the stump. Harvesting added $3.1 billion in value, primary manufacturing added $8.8 billion, transportation and marketing added $9.3 billion. Additional value was added through secondary manufacturing and construction. Thus, forest management has beneficial effects upon numerous sectors of our economy, and benefits the entire nation.

C. Impact on Inflation

If future timber supplies are inadequate, serious inflationary consequences may result. Future shortages of timber are expected to exert pressure on the price of wood building materials and housing. These effects will be felt throughout the entire economy.

D. Forest Products Are Important to International Trade and Our Balance of Payments

Forest products are one of our nation's most important exports. Indeed, until recently, they represented our nation's second greatest source of exports, with only agriculture accounting for a greater share.

Significantly, a major portion of these exports are being made to countries such as Japan, Canada, and the EEC countries, with which we need to increase our balance of payments. Other important export markets include South Korea, Taiwan, and China.

In the last several years, however, the forest products industry has lost market share overseas on account of United States policies that have caused high exchange rates for the dollar relative to other currencies, high trade deficits, and high real interest rates.

The United States Forest Service estimates that exports of timber will fall from 1.8 billion cubic feet in 1976 to 1.3 billion cubic feet in 2030. Moreover, at the same time that exports are projected to be declining, imports are estimated to be rising from 2.8 billion cubic feet in 1976 to 4.5 billion cubic feet in 2030.

Unsound federal tax policies regarding timber will further impede our ability to compete internationally, rather than tapping the potential to improve our balance of payments.

E. Difficulties in Attracting Capital

The abundance of our forest resources is a strength enjoyed by few other nations. Yet, because of the unique nature and requirements of timber growing, the commitment of major amounts of capital over unusually long periods of time is required to develop, maintain, and utilize that resource in the most efficient way.

Principal deterrents to attracting capital are the historically modest rates of return on timber investments, compounded by the illiquidity of the timber investments and the long growing periods involved. For example, in the western United States, no portion of the capital invested may be recouped for 30 years, with the recovery of the investment being made thereafter over the harvest cycle, a total of 50 years or more. Regardless of where the timber is growing, the forest investor must make cash outflows annually to maintain and protect his property. These costs include payments for annual property taxes, fire, insect and disease prevention, and other timber management expenses.

The risks involved in timber growing and management are unusually high. The investor faces the threat of possible loss, fires or other hazards. In the case of fire, timber can be totally destroyed, leaving little, if any, salvage value to the owner. In the case of damage caused by wind, ice, disease, and insects, the value of the asset can be greatly diminished, and its capacity for production seriously impaired for many years. It is significant that casualty loss insurance is simply not available on standing timber at realistic rates. This is a reflection of the magnitude of the risks undertaken by those who grow timber.

And then there is the final risk. After making the initial investment decades earlier and after managing the property year after year, the timber owner finally sees the timber attain harvest size. He is then subject to the vagaries of the market, one that is notoriously sensitive to declines in the home building industry, and that, due to the then-prevailing exchange rates, may be wracked by low-priced imports.

So, the combination of relatively modest predicted rates of return, high carrying costs and the natural and economic risks involved in timber growing make it extremely difficult to attract the level of capital investment required to make the nation's timberlands sufficiently productive to meet anticipated needs.

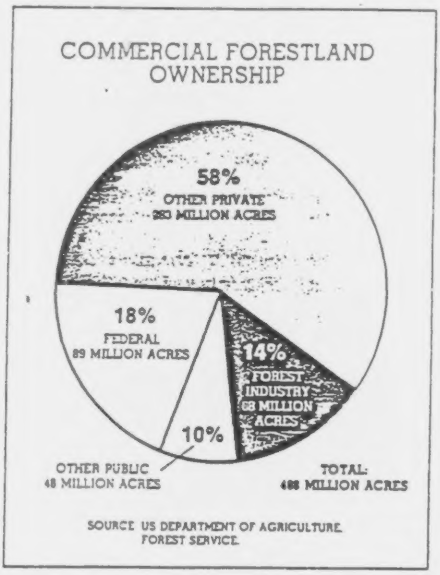
These are the handicaps which must be addressed by our nation's policy makers if we are to anticipate and prepare adequately for the timber supply needs of the United States in the next century, because we cannot wait until a shortage is upon us to take remedial action. We will never find a way to grow trees in that short a time.

If we are to keep capital flowing to timber so that the investment required to meet our future needs will be made, we must maintain, if not improve, the desirability of timber investments relative to other investments.

F. Increase In Timber Supply Must Come In Large Measure From Private, Non-Industrial Landowners

Table III shows the distribution of forestland ownership in this country. Of the categories shown, the greatest potential for increased production comes from the 283 million acres owned by private landowners. In general, these lands produce wood at only about 63 percent of their potential capacity.

Table III



COMMERCIAL FORESTLAND OWNERSHIP

SOURCE US DEPARTMENT OF AGRICULTURE
FOREST SERVICE

Individual non-industrial timber owners must contend with issues raised and burdens imposed by both the federal income tax and the estate tax. Both aspects are discussed later in this statement.

III. DISCUSSION OF POSSIBLE OPTIONS TO INCREASE REVENUES PROPOSED IN THE PAMPHLET PREPARED BY THE STAFF OF THE JOINT COMMITTEE ON TAXATION WITH THE STAFF OF THE COMMITTEE ON WAYS AND MEANS.

Pursuant to H. Con. Res. 93, the Concurrent Resolution on the Budget for Fiscal Year 1988, the Committee on Ways and Means has been asked to report legislation which raises revenues by prescribed amounts. Possible legislative options or proposals in this regard have been summarized in the Joint Committee Print dated June 25, 1987 entitled "Description of Possible Options to Increase Revenues Prepared for the Committee on Ways and Means" prepared by the Staff of the Joint Committee on Taxation with the Staff of the Committee on Ways and Means (hereinafter referred to as the "Pamphlet").

We believe that in fulfilling its role in making our nation's tax policy, the Committee on Ways and Means should be mindful of the economic importance of timber as an essential natural resource. Unsound tax policy with respect to timber can have a devastating effect upon our nation's future timber supply. In this regard, we would like to comment specifically upon a number of proposals set forth in the Pamphlet.

A. Proposals Relating Primarily To Federal Income Taxation

1. The proposal to reduce the maximum tax rate on individual capital gain to 15% would encourage necessary investment in timber by individual non-industrial timber owners. Such reduction should also be accompanied by a reduction in the maximum tax rate on corporate capital gain for similar reasons and to avoid competitive distortions.

Under current law, most timber income is treated as long-term capital gain. Capital gain treatment applies to timber as a result of either the general provisions of Internal Revenue Code ("Code") Sections 1221 and 1231, applicable to all taxpayers, or the specific provisions of Section 631(a) and (b), applicable only to timber owners.

Prior to the enactment of the Tax Reform Act of 1986, long-term capital gains realized by both corporate and non-corporate taxpayers were taxed at more favorable rates than ordinary income. As a result of this recent legislation, however, long-term capital gains will generally be taxed at the same rates as ordinary income.[2/]

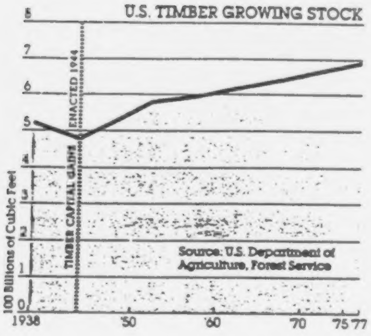
The Pamphlet sets forth a proposal to reduce the maximum tax rate on individual net capital gains to fifteen percent. See Pamphlet at p. 242. We believe that a reduction in the maximum rate of tax on the capital gains of individuals would be a useful step toward encouraging much-needed investment in timber. However, we believe that the maximum capital gains tax rate of corporations should also be reduced.

The history of timber taxation makes it clear that the capital gains treatment of timber has served as a powerful incentive to encourage investment in timber. In 1944, Congress extended capital gain treatment to the full range of qualified timber transactions rather than only to lump sum, liquidation-type sales. What followed was the most dramatic change in growth and planting in the history of American private forestry.

Tables IV and V show the impact in terms of U.S. timber growing stock and annual plantings in private forests. Prior to 1944, seven billion cubic feet more timber was harvested than was grown annually. Since 1944, we have grown an average of over four billion cubic feet more than we harvested each year, a substantial net gain. And, in the case of planting, annual plantings on private lands have increased from practically zero to over two million acres per year.

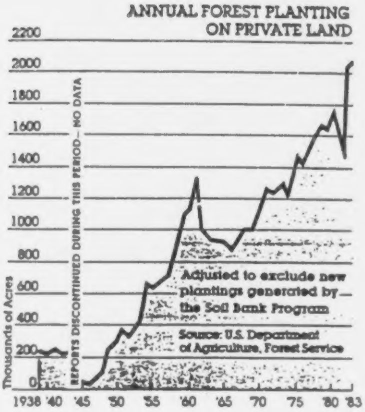
2/ Long-term capital gains of corporate taxpayers will be taxed at the same rate as ordinary income for taxable years beginning on or after July 1, 1987. See Internal Revenue Code of 1986 ("I.R.C.") secs. 11, 1201(a). Long-term capital gains of non-corporate taxpayers will be taxed at the same rates as ordinary income for taxable years beginning on or after January 1, 1988. See I.R.C. secs. 1(a), 1(h), 1(j).

Table IV



Source: U.S. Department of Agriculture, Forest Service

Table V



Source: U.S. Department of Agriculture, Forest Service

This history makes it clear that the treatment of timber gain as capital gain, with its corresponding favorable rate of tax, has had a dramatic effect upon reforestation and investment in timber. By causing capital gains and ordinary income to be be taxed at the same rates, the Tax Reform Act of 1986 essentially eliminated the benefits of capital gain treatment for timber.[3/] In light of the substantial up-front capital requirements, the long growing periods, and the inherent natural and economic risks involved in growing timber, we believe that the lack of any tax rate differential between capital gains and ordinary income will act as a disincentive to investment in timber. By contrast, reducing the maximum tax rate on capital gains of both individuals and corporations would encourage much needed reforestation and investment in timber.

Sound reasons of tax policy support a reduction in the maximum corporate capital gains tax rate along with a reduction in the maximum individual capital gains tax rate. Historically, both corporate and individual capital gains have each been taxed more favorably than ordinary income. By reducing the tax rate on capital gains of individuals, but not corporations, tax considerations would become a significant factor in determining the form of doing business. For no economic reason, partnerships and proprietorships would be

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3/ See note 2, supra.

favored over corporations. Such treatment results in a competitive disparity between corporate and non-corporate taxpayers. By providing a favorable maximum rate on capital gains for individuals, but not for corporations, the law would in effect penalize corporations for making risk capital investments. This is particularly anomalous since much available risk capital comes from corporate sources.

It should be noted that a substantial body of economic opinion asserts that a reduction in the maximum tax rate on capital gains for corporations as well as for individuals will have a positive revenue effect. The historical record confirms this view. For instance, even though the corporate capital gains tax rate was reduced in 1978 from 30% to 28%, corporate capital gains tax receipts were more than 13% higher in 1982 than in 1978, despite the severe recession in 1982.

Thus, sound tax policy, historical precedent, the need for increased timber investments, the need for and availability of risk capital, and the favorable revenue impact all argue for a reduction in the maximum tax rate on capital gains for both individuals and corporations.

2. The present like-kind non-recognition rules permit timber owners to make necessary exchanges of timberland without the immediate imposition of tax and should be retained.

The Pamphlet sets forth a number of possible proposals relating to like-kind exchanges. Under one such proposal, real estate would be added to the types of property ineligible for like-kind treatment under the non-recognition rules. Under another proposal, the current "like-kind" standard would be replaced by a stricter "similar or related in service or use" standard. Under a third alternative, like-kind exchange treatment could be made applicable only to simultaneous transfers. See Pamphlet at pp. 240-241.

We believe that these proposals to alter the like-kind provisions of current law would have a detrimental effect on our nation's timber growers.

In the course of managing forest lands, a timber owner may find it appropriate or desirable to effect like-kind exchanges with respect to timberland. Circumstances such as changes in boundary lines, changes in mill location, and the like, may render it necessary or desirable to exchange one parcel for another. Such transactions should not give rise to immediate tax liability, since the forest owner has not received cash or sufficiently changed the form of his investment to warrant the imposition of a tax. Requiring simultaneous transfers in order to qualify for non-recognition treatment would inhibit forest owners from improving the productivity of these lands and would virtually preclude three or four-party exchanges which are not uncommon in the industry. In this latter respect, we believe that the restrictions on the timing of exchanges imposed by the Deficit Reduction Act of 1984 should be sufficient to remedy any abuses in this area.

3. The proposal to reduce the amount of reforestation expenditures eligible for amortization and for the investment tax credit would serve as a disincentive to investment in timber.

Under current law, up to $10,000 of a timber grower's reforestation expenses annually may qualify for amortization deductions over an 84 month period and for a 10 percent investment tax credit. This provision is uniquely focused on encouraging small landowners to regenerate their timber holdings.

The Pamphlet sets forth proposals to reduce the value of certain specified "tax preferences" contained in the Internal Revenue Code. *See* Pamphlet at pp. 88-89. Included among these proposals is the suggestion that the current ten percent (10%) credit for reforestation expenses be reduced. It is also proposed that the amount of amortizable reforestation expenses be reduced below the current $10,000 level.

We believe that any such reductions with respect to the reforestation credit and amortization provisions are unsound.

The reforestation credit and amortization provisions, which have been effective for taxable years beginning after December 31, 1979, were added to the Internal Revenue Code in recognition of the need to encourage reforestation activities. This need is well documented and is as acute today as it was when these provisions were first enacted. By keeping these provisions intact under the Tax Reform Act of 1986, Congress demonstrated its intent to continue to encourage the reforestation activities which are so vital to maintaining and improving our nation's timber supply. These reforestation incentives are but a small step toward ensuring an adequate supply of timber in future years.

The current $10,000 annual limit on expenditures eligible for amortization and for the credit is already inadequate. If it costs approximately $200 to reforest an acre of timberland, the current $10,000 limit provides an incentive to reforest only 50 acres of timberland. This represents only a small portion of our nation's acreage in need of reforestation.

The present statutory scheme already contains a number of restrictions which significantly limit the value of the credit and amortization deductions. Irrespective of the aggregate amount of reforestation expenditures incurred by the timber owner during the taxable year, the 10 percent credit is available only with respect to the $10,000 annual limit of qualifying expenditures (*i.e.*, a total credit of $1,000). Similarly, the amortization provisions allow the timber owner to recover only up to $10,000 of reforestation costs; such recovery is permitted only through level or "straight line" amortization over an 84-month (seven-year) period. In contrast, under the ACRS system, even as modified by the Tax Reform Act of 1986, many taxpayers are permitted to recover capital costs by using accelerated methods over recovery periods as low as three or five years. The imposition of further restrictions on the value of the credit and amortization deductions would seriously undermine the goal of promoting reforestation.

The current $10,000 limitation serves to limit the benefit of the reforestation amortization and credit provisions primarily to small non-industrial landowners. Moreover, the costs of providing these incentives will be recouped by the Treasury many times over when the trees which are planted as a result of these incentives are harvested.

4. If applied to timber, the proposal to treat farm losses like rental real estate losses under the passive loss rules would discourage forestry investment.

The Pamphlet contains a proposal to treat farm losses like rental real estate losses for purposes of the passive loss rules. Under the proposal, a farming activity would generally be considered *per se* a passive activity, irrespective of the taxpayer's level of participation therein. However, an individual taxpayer who "materially participates" in a farming activity could deduct up to $25,000 of losses from such activity against income from other sources (*i.e.*, irrespective of the limitations of the passive loss rules). The proposal does not specify that it applies to timber growing, and we believe the Committee should specify that it does not. In any event, we oppose this proposal, particularly insofar as it might apply to timber growing activities.

The Pamphlet itself contains several persuasive arguments against the proposal, all of which apply with equal or greater force in the case of timber growing. First, it is recognized that farming is generally a risky business in which many individuals lose money and that such losses should be available to offset other income prior to disposing of the farm. So too, timber growing is a risky business in which the hazards of natural and economic losses are ever present. Expenditures by timber owners represent actual, unleveraged, out-of-pocket expenses. Such expenditures should be currently deductible. The rationale for treating rental activities as *per se* passive activities is as inapplicable to timber growing activities as it is to farming activities generally.

The arguments cited in the Pamphlet in favor of this proposal are not persuasive. It is argued, for instance, that high income taxpayers often use farm losses as a "tax shelter" to offset non-farm business income. This contention ignores the effect of the passive loss rules themselves. Under those rules in their present form, farming losses can only be used to offset other income if the taxpayer "materially participates" in the farming activity. We know of no reason why the passive loss rules as currently drafted are insufficient or ineffective to prevent any "tax shelter abuses" which may occur with respect to farming losses. And, in particular, as we have testified many times before, there are no "tax shelters" that we know of in the timber economy.

B. Proposals Relating Primarily To Federal Estate And Gift Taxation

1. General Impact of Estate and Gift Taxes on Timber Growing

As noted above, in the nation as a whole, close to 80% of the total privately-owned forest acreage is held by non-industrial owners: approximately 7 million owners. As land prices and development pressures escalate, the estate and gift taxes will fall most heavily on these individuals. Individually, their ownerships are small. In the aggregate, they account for a major portion of the total forest resource.

Because of the long growing period for timber, estate taxes have a particularly adverse impact on private forestland owners. Depending on the region, tree species, and forest management practices, timber crops require between 30 and 100 years to reach harvestable size. This lengthy growing period often results in timber passing through several estates between planting and harvest. It is in such situations that the impact of estate taxes is most severe.

The significance of the long growing period for timber is underscored by an American Forest Institute survey which shows that 37 percent of all tree farmers in 1972 were over 60 years old and 28 percent were between 50 and 60 years of age. These statistics indicate that the families of 65 percent of the owners of private forestlands could well be involved in estate tax proceedings between now and the end of the century. Thus, the impact of estate taxes may well be greater for timber owners than for persons involved in other sectors of our economy.

Excessive federal estate taxes result in a substantial disincentive to forestry investments and to reforestation, and force premature harvesting of our nation's private forestlands. Our tax policy should not interfere with meeting the timber supply needs of future generations of Americans.

a. The Estate Tax is Inefficient and Inequitable

We believe that the present estate tax is both inefficient and inequitable. The current tax is inefficient because it discourages capital intensive investments. Due to the substantial tax that may be imposed upon death--55 percent today on transfers over $3 million and 50 percent for transfers over $2.5 million after 1987--those in the best position to make meaningful capital investments are encouraged, instead, to make investments in liquid assets with which their estates might more easily satisfy their estate tax obligations. Thus, the estate tax at its current levels continues to frustrate our national goals of stimulating capital investment.

The estate tax is also inequitable because it favors consumption over savings and capital formation. Two otherwise equally situated taxpayers--one spending all that he earns, the other saving as much as possible--are taxed in dramatically different ways upon their deaths. The taxpayer who consumed his earnings has no estate, and thus is not subject to estate tax. The taxpayer who saved, however, is subject to an estate tax simply as a result of having acquired an estate.

b. Significant Estate Taxes Adversely Affect Private Nonindustrial Forestlands

Both prior to and after a timber owners death, the existence of significant estate taxes has adverse effects upon private nonindustrial forestlands and thus, upon our nation's forest resources as a whole.

Prior to the timber owner's death, the existence of a significant estate tax discourages reforestation. Since the lengthy average growing time for timber may mean that the trees will mature long after the death of the planter, an owner's primary purpose in replanting may be to provide for and benefit his heirs. Yet, before the trees grow to a size that will yield a fair return, the owner will die and the trees may have to be cut in order to pay estate taxes. Knowing this, the timber owner may prefer not to reforest and instead to invest for the benefit of his heirs in other assets.

The imposition of significant estate taxes has an even more detrimental effect upon forest resources after a timber owner's death. Frequently, the estate of a timber owner faces liquidity problems. The executor of such an estate must make difficult and quick decisions in the face of a limited market. If the land is owned jointly with another private owner who is reluctant to cut timber or has differing objectives, lengthy court proceedings are often necessary to arrange partition, and valuation problems are severe.

Even in the case of outright fee ownership, drastic harvesting may be required. The estates of timber owners are often forced to cut timber prematurely in order to pay estate taxes. Rapid liquidation of timber simply for purposes of meeting tax liabilities is poor forestry practice because it may not coincide with either optimal biologic or economic manage-ent considerations. Harvesting a large timber inventory all at once can disrupt seed sources, wildlife, watersheds, and other benefits of the forest. It also tends to disrupt the local market price. Liquidation of a large timber source may also be physically and economically impossible due to limited markets, limited labor, limited transportation, and other problems. The executor's option of a sale of standing timber is therefore often impractical and may cause poor forest practices. In addition, lenders are generally reluctant to make loans based on the land as security.

The fragmentation of timberlands through forced sales invariably leads to the reduction or elimination of intensive forest practices. In more urbanized areas where the ownerships are small, land tends to be sold for development because this is the only way heirs can generate funds to pay the estate tax.

Thus, in order to encourage forestry investment, reforestation, and sound management practices, and in order to prevent the breakup of family ownership of timberland and the diversion of such land from timber growing uses, additional estate and gift tax relief is needed. Yet, the numerous proposals suggested by the Staff of the Joint Committee on Taxation with the Staff of the Ways and Means Committee would increase the already heavy burdens imposed by the estate and gift taxes. Accordingly, we believe that such proposals would have a devastating effect on forest resources owned by private individuals. Particularly for private timberland owners, the new proposals are simply untenable.

2. Specific Possible Options Relating to Federal Estate and Gift Taxation

a. The proposal to increase the maximum gift and estate tax rates for transfers at higher levels, the retention of rates applicable in 1987 for transfers made thereafter, and the proposed reduction or phase-out of the unified credit would compound the present adverse effects of such taxes upon timber owners and would particularly burden small and middle-sized estates.

Under present law, the estate and gift tax rates for 1987 begin at 18 percent on the first $10,000 of transfers and reach 55 percent on transfers over $3 million. For transfers after 1987, the highest gift and estate tax rate is scheduled to decline to 50 percent for transfers over $2.5 million. The Staff of the Joint Committee on Taxation with the Staff of the Committee on Ways and Means has proposed that the maximum gift and estate tax rates should be increased for transfers at higher levels (*e.g.*, 65 percent on transfers in excess of $10 million). Alternatively, it has been proposed that the estate and gift tax rates applicable in 1987 should be retained for transfers made after 1987 (*i.e.*, the progressive tax rates which begin at 18 percent on the first $10,000 of transfers and reach 55 percent on transfers over $3 million). *See* Pamphlet at pp. 258-260.

It has also been proposed that the amount of the unified credit should be reduced. The example given in the possible proposals is that the unified credit could be set at its 1982 level (i.e., $62,800 or an exemption equivalent of $225,000) and indexed for subsequent inflation. Alternatively, it has been proposed that the unified credit should be phased out for large transfers, such as transfers in excess of $10 million. See Pamphlet at pp. 258-260.

A higher estate tax rate is simply unjustifiable. Many types of estate assets, particularly farms and timberland, are illiquid, and high estate taxes result in forced sales or timber cutting. New increases in the estate and gift tax will further discourage needed incentives for capital investment in our forest resources.

Another proposal provides for a single flat rate for the gift and estate tax, e.g., 50 percent if the maximum rate of present law is retained. The recommendation of the Task Force on Transfer Tax Restructuring of the Section of Taxation of the American Bar Association ("Task Force") is cited as supporting this proposal. See Pamphlet at pp. 258-259. It has also been argued that the current gift and estate tax rates are nearly flat, since with the present level of the unified credit, the gift and estate tax rates effectively begin with a rate of 37 percent on transfers in excess of $600,000 and reach a maximum rate of 55 percent on transfers in excess of $3 million (50 percent on transfers in excess of $2.5 million after 1987). The recommendation of the Task Force does not necessarily support the proposed single flat tax rate in its current form. The Task Force recommendation assumes that a flat rate would be used in conjunction with a substantial exemption (equal to the current $600,000 exemption equivalent). The proposal, on the other hand, makes no mention of using the proposed flat tax rate in conjunction with an exemption; in addition, as noted above, it has been proposed that the amount of the unified credit should be reduced. Another purpose underlying the Task Force's recommendation is that use of a flat tax rate would simplify estate planning, a fact which the current proposal does not reflect. In fact, imposition of a flat tax would mean that the full utilization of the lower rate brackets for estates of both spouses currently used by many estate planners would be lost.

Finally, reduction of the unified credit would subject many small and middle-sized estates to federal estate tax and seems unfair.

The revenue effect of freezing the 1987 rates is expected to generate $0.5 billion in fiscal years 1988 through 1990, and the increase of the highest estate tax to 60 percent (or 65 percent as noted in the proposal) for transfers in excess of $10 million is expected to generate $0.3 billion during those years. In light of the burden imposed and the consequent effects on long-term timber holdings, these anticipated increases in revenues do not justify freezing the 1987 rates or increasing the highest estate tax to 60 or 65 percent on transfers in excess of $10 million.

b. The proposed imposition of a 2% estate tax on assets less liabilities held at death with no unified credit allowed would also be particularly burdensome to small family businesses and individuals with forest acreage.

Another possible proposal would impose a 2 percent estate tax on the assets less liabilities held by a decedent at death with no unified credit allowed. This proposal is projected to generate $1.8 billion in fiscal years 1988 through 1990.

The proposed 2 percent estate tax appears to be a tax in addition to the already-existing estate tax structure and, as noted above, is to be calculated without allowance for any unified credit. It is unclear whether this 2 percent estate tax would apply even to estates which are transferred to a surviving spouse and thus would qualify for the marital deduction. This provision would result in an additional $20,000 estate tax on every $1 million of assets, minus liabilities, held at the time of the decedent's death. The immediate impact of this proposal is that an estate tax would apply to all estates, small as well as large. The provision would impose new burdens upon individuals who own small family businesses and individuals who own forest acreage, and would increase the necessity of the sale of forest land or the forced cutting of timber.

c. The proposed income tax on net appreciation in property passing from a decedent at death and the proposed carry-over basis rules would have significant adverse economic effects upon timber owners and would create enormous administrative complexity.

The most devastating of the possible proposals is the potential imposition of income tax on the net appreciation in property passing from the decedent at death. Relatively small estates would be exempted from such an appreciation tax because the tax could be offset by an exemption or any unused portion of the decedent's unified credit. Under the proposal, property passing to a surviving spouse or charity would not be subject to the appreciation tax, but would receive a carryover basis similar to that provided by transfers by gift (i.e., the decedent's basis with adjustments for gift tax paid). In the alternative, it has been proposed that a partial credit might be permitted against the estate tax for the decedent's basis in property includable in his gross estate, because it could achieve a similar result. In order to increase revenue, the enactment of the credit would be coupled with increased estate tax rates.

A third alternative is that the basis of an asset acquired from a decedent could be made equal to the decedent's basis in the asset (i.e., a carryover basis).

These proposals--particularly taxing of appreciation at death--would have disastrous effect upon the owner of a family business or owners of timberlands. In essence, under current law, any appreciation in the value of property between the date of acquisition by the decedent and the date of death is not subject to income tax because of the "stepped-up basis." Ironically, it is those persons that previous revisions in estate tax laws were designed to assist--surviving spouses, farmers and small businessmen and persons with small estates--who will suffer most from the adverse effects of this proposed provision. Frequently, a decedent's basis in timberlands often is disproportionately low--particularly if the land was inherited from previous generations--and the very nature of the investment in a growing resource ensures that the appreciation element will constitute a significant part of its value. Thus, the appreciation element of timber is often greater than that of other investments. The imposition of both an appreciation tax and an estate tax which must be paid at the same time will force the heirs of estates consisting primarily of timberland to liquidate the timber holdings to meet these taxes far more frequently than heirs of estates consisting of other kinds of assets.

These proposed revisions create an administrative jungle. The process of taxing appreciation at death or determining a carryover basis is incredibly complex, and these complexities increase enormously when long time periods, often covering several generations, are involved. First, the decedent's basis in each asset in his estate must be determined. A decedent rarely leaves adequate records concerning the date of purchase, cost, and capital improvements for each asset owned. Even if there are records, establishing the basis of a farm or closely-held business, with property frequently purchased in small lots over the years, improvements constantly being made and depreciated, and numbers of other business assets being acquired or disposed of, can involve enormously complex calculations.

Establishing the original cost basis is particularly burdensome for timber owners. It is difficult enough for an heir to determine the cost basis of his immediate predecessor, *i.e.*, the person from whom he inherited the property. The difficulty of reconstructing the original cost basis record when a great-grandfather planted trees 80 years ago--three or more deaths earlier--increases the opportunity for lost or obscure records during each lifetime. It is also extremely difficult to determine the cost basis for each tract of timber in the event each tract is cut or sold at different times.

To the extent that any appreciation tax or carryover basis rule reduced the return on timber investments, it would lower the threshold for the breakup of family timber holdings, thus interrupting the continuity of timber production and inhibiting the broad, private ownership of timberlands.

d. The current "estate freezing" techniques should be retained, as they provide a way to ameliorate the heavy burden already imposed by the estate and gift taxes on timber ownership and similar activities where long holding periods are involved.

Another possible proposal is that a decedent's estate should include the full value of property which is effectively subject to the decedent's retained life interest and that a life estate with the power of appointment could be deemed as not passing to a decedent's spouse for purposes of the marital deduction unless the spouse's power is expressed as a fraction or a percentage of the estate. It has also been proposed that the value of property for federal estate, gift and generation-skipping transfer tax purposes could be determined by aggregating other interests in the property owned by related individuals. Alternatively, the value of stock in closely-held corporations could be deemed to be a proportionate share of the corporation's value for those purposes.

Currently, the value of property includable in a decedent's gross estate is its fair market value at the date of the decedent's death (or on the alternate valuation date if the executor so elects). Under current law, where an individual transfers a remainder interest in property but retains the income from that property for his life, his gross estate includes the full value of the property. An individual may, however, exclude from his gross estate the value of common stock transferred to others, even though he retains preferred stock in that corporation with the right to most dividends. An individual may also exclude from his estate the value of an option to purchase property owned by him, despite his enjoyment of the property prior to the exercise of the option.

Estate planners use these rules to "freeze" the value of property so that appreciation in the estate's assets accrues to the owners' children and is thereby excluded from the gift and estate tax base. One method includes recapitalizing a closely-held corporation so that both voting preferred and common stock are outstanding. The par value of the preferred stock is set at the estimated value of the corporation at that time, and the owners give the common stock to their children and retain the preferred stock for themselves. Because the par value of the preferred stock is set at the estimated value of the corporation, the common stock has little value, and as a result, there is little or no gift tax owed. At the owners' death, the executor values the preferred stock at its par value (*i.e.*, the value of the preferred stock is "frozen" at the time of the recapitalization). Appreciation in the value of the common stock accrues to the children and passes between generations without being subject to gift or estate taxes.

Another technique for freezing the value of property is for a property owner to grant to his children a long-term option to purchase the property at its current value. Since the option price is the value of the underlying property at the time the option is granted, the value of the option is claimed to be very low. Nonetheless, the option is said to limit the value of the property to the option price, allowing appreciation to avoid estate tax.

A third method for freezing the value of property is for an individual to give a spouse an income interest in a trust, combined with a general power of appointment over a specified dollar amount. Under the marital deduction, no gift tax is imposed upon the gift to the spouse and the spouse would include only the specified amount in her estate. Thus, any appreciation in the value of the trust will not be taxed in either spouse's estate.

Finally, it has also been observed that numerous courts recognize that shares of stock which represent a minority interest in a corporation are usually worth less than a proportionate share of the value of the assets of the corporation. One court has allowed a minority discount even though the total shares owned by related persons constituted a majority interest. It has been argued that a minority discount is proper only where the owners have adverse interests and that related persons generally share the same interests. It has also been argued that the recapitalization technique described above allows a parent effectively to retain a life interest in a corporation by keeping the voting preferred stock. Similarly, the option technique permits a parent effectively to retain a life estate and transfer a remainder interest to the children.

These valuation freezing techniques comply with current law and are often the only means of passing small businesses intact to future generations. Moreover, retaining preferred stock and property owned subject to an option provide rights significantly different from those of a retained life estate. Any abuse of estate freezing techniques is not due to the retained estate but in undervaluation of the gift (i.e., of common stock or the option). With regard to minority discounts, family members do not always share the same interests, and in those situations, disallowing a minority discount will result in overvaluation of property for gift, estate and generation-skipping transfer tax purposes. The projected revenues resulting from the proposed prohibition against estate freezing techniques and disallowance of minority discounts do not justify their implementation.

As noted above, the imposition of significant estate taxes adversely impacts upon private timber holdings. Unless some other relief from such taxes is afforded to timber owners and their estates, planning techniques such as those described herein should remain available. These estate freezing techniques and minority discounts provide for amelioration of the otherwise often impossible burden imposed on privately-owned timberlands by the current estate and gift tax rates and the generation-skipping tax.

IV. CONCLUSION

Assuring an adequate supply of timber is a vital national goal. Due to historically modest rates of return, coupled with associated natural and economic risks, it has been difficult to attract much needed reforestation and investment in timber. Our Federal tax policy should encourage, not discourage, such reforestation and investment. The various proposals to increase revenue set forth in the Pamphlet must be considered in this light.

In the Federal income tax area, we support the proposal to reduce the maximum tax rate on net capital gains of individuals, and we recommend similar treatment for capital gains of corporations. Historically, capital gain treatment for timber has proved to be a powerful incentive for forestry investment. We believe that the like-kind exchange rules of current law should be retained. We also believe that the proposal to limit the amount of reforestation expenses eligible for amortization and for the investment tax credit would discourage much needed reforestation and investment in timber. If applied to timber, the proposal to treat farming losses like rental real estate losses under the passive loss rules would similarly have an adverse effect.

The heavy burdens imposed by current estate tax laws interfere with providing an adequate supply of timber for the future. The possible options to increase revenue proposed by the Staff of the Joint Committee on Taxation with the Staff of the Committee on Ways and Means, and particularly the proposed income tax on the net appreciation in property passing from a decedent at death, would have a devastating effect upon private forest landowners, and accordingly, upon reforestation and investment in timber growing to meet the future's needs.

Providing fair and equitable federal income, estate and gift tax treatment for private owners of our nation's forest lands is essential. We appreciate the efforts of the members of the Committee on Ways and Means who recognize the effect of federal taxes on timber growing and look forward to working with them concerning the recommendations outlined in this written statement.

APPENDIX A

COOPERATING ASSOCIATIONS

Alabama Forestry Association
Montgomery, Alabama

Alaska Loggers Association, Inc.
Ketchikan, Alaska

American Institute of Timber
Construction
Englewood, Colorado

American Paper Institute
New York, New York

American Plywood Association
Tacoma, Washington

American Pulpwood Association
Washington, D.C.

Appalachian Hardwood Manufacturers,
Inc.
High Point, North Carolina

Arkansas Forestry Association
Little Rock, Arkansas

Associated Cooperage Industries
of America, Inc.
Louisville, Kentucky

Associated Oregon Industries, Inc.
Salem, Oregon

Association of Consulting Foresters
Bethesda, Maryland

California Forest Protective
Association
Sacramento, California

Eastern North Carolina Lumber
Manufacturers Association, Inc.
Rocky Mount, North Carolina

Fine Hardwoods-American Walnut
Association
Indianapolis, Indiana

Florida Forestry Association
Tallahassee, Florida

Forest Farmers Association
Atlanta, Georgia

Forest Landowners of California
Sacramento, California

Georgia Forestry Association, Inc.
Atlanta, Georgia

Hardwood Manufacturers Association
Memphis, Tennessee

Hardwood Plywood Manufacturers
Association
Reston, Virginia

Industrial Forestry Association
Portland, Oregon

Kentucky Forest Industries Association
Monticello, Kentucky

Louisiana Forestry Association
Alexandria, Louisiana

Lumber Manufacturers Association
of Virginia
Sandston, Virginia

Maine Forest Products Council
Augusta, Maine

Maine Hardwood Association
Augusta, Maine

Maryland Forest Association, Inc.
Salisbury, Maryland

Michigan Forest Association
Midland, Michigan

Michigan Forest Products Council
East Lansing, Michigan

Michigan-Wisconsin Timber Producers
Association
Tomahawk, Wisconsin

Minnesota Timber Producers Association
Duluth, Minnesota

Mississippi Forestry Association
Jackson, Mississippi

Missouri Forest Products Association
Jefferson City, Missouri

National Christmas Tree Association
Milwaukee, Wisconsin

National Dimension Manufacturers
Association
Marietta, Georgia

National Forest Products Association
Washington, D.C.

National Hardwood Lumber Association
Memphis, Tennessee

National Lumber Exporters Association
Memphis, Tennessee

National Oak Flooring Manufacturers
Association
Memphis, Tennessee

National Particleboard Association
Silver Spring, Maryland

National Woodland Owners Association
Vienna, Virginia

New Hampshire Timberland Owners'
Association
Concord, New Hampshire

New Jersey Forestry Association
Trenton, New Jersey

New York Forest Owners Association
Tully, New York

North Carolina Forestry Association
Raleigh, North Carolina

North Idaho Forestry Association,
Inc.
Coeur D'Alene, Idaho

Northeastern Lumber Manufacturers
Association, Inc.
Falmouth, Maine

Ohio Forestry Association, Inc.
Columbus, Ohio

Oklahoma Forestry Association
Broken Bow, Oklahoma

Oregon Forest Protection Association
Salem, Oregon

Pacific Logging Congress
Portland, Oregon

Society for the Protection of
New Hampshire Forests
Concord, New Hampshire

South Carolina Forestry Association
Columbia, South Carolina

Southern Cypress Manufacturers
Association
Memphis, Tennessee

Southern Forest Products Association
New Orleans, Louisiana

Southern Oregon Timber Industries
Association
Medford, Oregon

Southwest Pine Association
Phoeniz, Arizona

Tennessee Forestry Association
Nashville, Tennessee

Texas Forestry Association
Lufkin, Texas

Virginia Forestry Association
Richmond, Virginia

Washington Farm Forestry
Association
Raymond, Washington

Washington Forest Protection
Association
Olympia, Washington

Western Forest Industries Association
Portland, Oregon

Western Forestry and Conservation
Association
Portland, Oregon

Western Timber Association
San Francisco, California

Western Wood Products Association
Portland, Oregon

Wisconsin Woodland Owners'
Association, Inc.
Madison, Wisconsin

JAIME B. FUSTER
PUERTO RICO

WASHINGTON OFFICE:
427 CANNON BUILDING
WASHINGTON, DC 20515
(202) 225-2615

DISTRICT OFFICE
P.O. BOX 4751
OLD SAN JUAN, PR 00902
(809) 723-6333

Congress of the United States
House of Representatives
Washington, DC 20515

COMMITTEES
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WESTERN HEMISPHERE
HUMAN RIGHTS AND
INTERNATIONAL ORGANIZATIONS

INTERIOR AND INSULAR AFFAIRS
SUBCOMMITTEES
INSULAR AND INTERNATIONAL AFFAIRS
ENERGY AND ENVIRONMENT
NATIONAL PARKS AND
PUBLIC LANDS

COMMITTEE ON
RECEIVED
JUN 10 1987
WAYS AND MEANS

July 7,

Mr. Robert J. Leonard, Chief Counsel
Ways and Means Committee
US House of Representatives
1102 Longworth HOB
Washington, D.C. 20515

Dear Mr. Leonard:

On behalf of the 3.5 million United States citizens who reside in Puerto Rico, I would like to offer my observations on three of the tax options now being considered by the Ways and Means Committee. These are the oil import fee, the increased excise tax on distilled spirits and a percentage reduction in the possessions tax credit. Much has already been said about the regional disparity of the impact of some of the proposed measures and of the regressive nature of some of the others. An oil import fee, it has been observed, would disproportionately hurt the Northeast, which uses a great deal of imported home heating oil, and helps the South Central part of the country which produces most of the nation's domestic oil. An increased excise tax on alcoholic beverages, which amounts to nothing more than a disguised sales tax, would fall most heavily on the poor, who use the bigger part of their income for consumption.

When the effect on Puerto Rico of these two taxes is factored in, the regional disparity and the regressivity become more pronounced. Puerto Rico is much more dependent on imported oil than is the United States. Virtually all of the island's electric power is generated from petroleum versus only 4% for the United States. Puerto Rico has no petroleum resources of its own, and the Jones Act requirement that all shipping between Puerto Rico and the mainland must be in U.S. ships makes U.S. oil too expensive.

In 1986 Puerto Rico imported 69.3 million barrels of petroleum products. Historically, about half these imports have been crude oil. At that rate of importation the proposed tax of $5.00 per barrel on imported crude oil and $7.50 per barrel on refined oil products would cost Puerto Rican consumers some $437 million or about 2.8% of Puerto Rico's GNP. By contrast, the $8.6 billion that the tax is predicted to raise in the United States represents only .2% of the nation's gross national product. This tax, then, would have a 14 times greater impact on Puerto Rico, a part of the country whose per capita income is a scant one third of the national average and where over 60% of the people have incomes below the federal poverty level.

There is precedent for granting special treatment to Puerto Rico with respect to oil imports. When crude oil import quotas were introduced in 1959 in the United States, a separate allocation was granted for Puerto Rico. When the quotas were changed to a fee system on May 1, 1973, fee-exempt licenses were granted for a period of years for various Puerto Rico importers. On February 1, 1975, the US Government, in addition to the fee of 0.21 per barrel of crude oil, imposed a supplemental fee of $1 per barrel which remained in force until June 1, 1975, when it became $2 per barrel on imported crude oil. Following the imposition of the $2 per barrel fee, President Ford authorized The Federal Energy Administration to reduce the $2 fee on imports to Puerto Rico by an amount equal to an excise tax or other levy imposed or collected by the Commonwealth of Puerto Rico.

The proposed increase in excise taxes on distilled spirits would affect Puerto Rico through the reduction it would cause in the refund of the tax on Puerto Rican rum, unless the full amount of the increase were to be refunded to Puerto Rico. From 1917 until 1984, as an integral part of Puerto Rico's political status arrangement with the United States, all U.S. excise taxes on products of Puerto Rico were returned to the Treasury of Puerto Rico. In 1984 the tax on distilled spirits was raised from $10.50 per proof gallon to $12.50 per proof gallon, but the refund to Puerto Rico and the U.S. Virgin Islands remained at $10.50. In the past year, partly because of the increase in the tax, Puerto Rico's shipment of rum to the U.S. fell from 23.2 million proof gallons to 18.7 million proof gallons. Even though it was less than in previous years, the $200.8 million in returned excise taxes in 1986 amounted to 6.9% of the revenues of the Commonwealth of Puerto Rico. An additional increase in the tax on distilled spirits would certainly cause an even greater decrease in rum sales in the United States resulting in serious fiscal problems for Puerto Rico. The problem would be greater if the distilled spirits excise tax increase were not accompanied by an increase in the tax on beer and wine to bring them up to the distilled spirits rate, and if the full excise tax refund to Puerto Rico were not to be restored.

Pursuant to this last point, we would remind the committee that, at the time of the enactment of the limitation of the refund which originated in the Senate, our Representative Resident Commissioner, Baltazar Corrada del Río was promised a "fair hearing" in the Ways and Means Committee by Representative Gibbons on behalf of Chairman Rostenkowski for Mr. Corrada's bill that would set aside the limitation. Before the gap between the tax collected and the amount refunded to Puerto Rico widens further, the committee must make good its promise to review this injustice.

Finally, we note that among the "tax preferences" which might be subjected to a percentage reduction is the possessions tax credit. This cornerstone of Puerto Rico's economic development has hardly stopped shaking from the assault it received in the Tax Reform Act of 1986. Important changes were made at that time whose full consequences are not yet clear. Further tinkering with this vital provision now is simply not called for and we would oppose it strenously.

Thank you very much for your careful consideration of our concerns.

Sincerely,

Jaime B Fuster

Jaime B. Fuster
Member of Congress

GARLIKOV & ASSOCIATES, INC.
The Huntington Center • 41 South High Street • Columbus, Ohio 43215 • 614/221-0900

July 21, 1987

The Honorable Dan Rostenkowski, III
Chairman, Committee on Ways and Means
U.S. HOUSE OF REPRESENTATIVES
Washington, D.C. 20515

Re: Change in Life Insurance
Policy Tax Law

Dear Mr. Rostenkowski:

I am requesting that you not support any legislation designed to raise revenue by changing the tax laws on life insurance policies. Specifically: 1) to tax the inside buildup of newly-issued life insurance policies; 2) any proposals which suggest taxing policy loans and/or withdrawals; and 3) taxing of cash values in policies by redefining life insurance so that the "investment-oriented" policies do not qualify as life insurance.

I am also against any proposal which would include death benefits in a decedent's estate when the benefits are payable to the decedent's relative(s), whether or not the decedent had transferred all incidents of ownership prior to the three-year period immediately preceding his or her death.

I feel comparatively little revenue is attributable to any of these proposals. Furthermore, it is unlikely that people will continue to purchase permanent life insurance if it is subject to tax.

I appreciate your show against these proposals. Thank you for your consideration.

Sincerely,

Don

Donald E. Garlikov
President

DEG:cls

GM STATEMENT ON TAXATION
HOUSE WAYS AND MEANS COMMITTEE

General Motors appreciates this opportunity to submit comments on the tax policy issues involved with the budget resolution. We believe it is important that Congress not tamper with the tax rate reductions included in the 1986 Tax Reform Act.

GM was an early and strong supporter of the idea of lowering tax rates and of the process that led to enactment of the Tax Reform Act of 1986. We believe our income tax system must be based on fairness. Also, we believe our system of taxation must encourage investment and consumption decisions by individuals and businesses based upon economic reasons rather than tax reasons. A system that raises revenue by applying low rates against a broad base will accomplish those objectives.

Reform was largely achieved when lower rates for individuals and businesses were substituted for the complicated system of preferences that had evolved over decades. Congress and the American people supported the elimination of preferences in exchange for lower rates. Indeed, the reform made sense only with the lowering of the rates. And these lower rates should yield significant economic benefits if they are allowed to be implemented.

To increase tax rates at this time would break faith with the taxpayers who gave up preferences in the Tax Reform Act of 1986. It would put us back on the road toward a policy of raising rates and reinstituting preferences to offset the negative effects of high rates. Preventing the rate reductions from taking effect will force the economy to forego the benefits that would result from individuals and business responding to the lower rates.

The Tax Reform Act of 1986 provided a tax cut to individuals which was largely financed by a $120 billion increase in corporate taxes. A tax increase of this magnitude will have an adverse impact on the investment plans of some firms. That adverse impact should be offset by the higher economic growth expected to result from the lower rates. Raising business taxes at this time would seriously jeopardize economic growth.

The Tax Reform Act of 1986 was viewed as a fundamental change of direction in our system of taxation, not as an interim measure or as a measure to be continually tinkered with. We believe it is critically important that Congress not abandon the commitment to reform it started in 1986. Stability and predictability are paramount at this time. Business needs time to adjust to the 1986 Act as well as to the other major tax bills enacted in recent years. To raise the rates now -- or to reconsider other measures considered during the tax reform debate -- would severely undercut public confidence in the ability of Congress to reform the tax code and stick with its commitment to a superior approach. Reneging on that commitment, ironically, at a time when other industrialized countries are beginning to lower their tax rates, would adversely affect investor confidence.

General Motors is also concerned with several of the more than 200 revenue-raising options developed by the staffs of the Ways and Means Committee and Joint Committee on Taxation. In particular, narrowly-based taxes, such as on petroleum, could have a severe impact on economic efficiency and growth. A petroleum tax also would adversely impact industries like the auto industry whose sales and employment would decline as consumers face higher gasoline prices. An increase in the price of gasoline would fall most heavily on owners of larger, family-sized vehicles. Since most larger cars are produced by domestic manufacturers, an increase in the price of gasoline would reduce sales of domestic models more than imports. The Japanese auto producers and others who specialize in smaller cars would benefit relative to the American manufacturers which produce a full line of vehicles.

General Motors believes the federal budget deficit must be reduced. The Gramm-Rudman-Hollings Balanced Budget Act has made us all aware of the difficult choices that must be made in setting our nation's priorities. GM believes the deficit should be reduced by reducing the rate of increase in federal spending. An increase in the corporate tax rates is the wrong way to solve the budget deficit.

In summary, we believe it would be economically harmful and fundamentally unfair to raise taxes by tampering with the tax rate reductions enacted last year or with other measures considered during the tax reform debate. We are ready to work with Congress to defend the progress made under the 1986 Tax Reform Act.

7/14/87

GOVERNMENT FINANCE
OFFICERS ASSOCIATION

1750 K STREET N.W.
SUITE 200
WASHINGTON, D.C. 20006
202 429-2750

Comments of the
Government Finance Officers Association
on
Revenue Increase Options*

The Government Finance Officers Association (GFOA) recognizes the crisis this nation faces over the forseeable future as we attempt to reduce the magnitude of the federal deficit. We fully appreciate the difficult task facing the Congress in this effort. The solution, however, cannot be simply to transfer the deficit onto state and local governments and their taxpayers and to abandon the well-established concept of the federal-state-local partnership. Accordingly, the Government Finance Officers Association offers the following comments on revenue increase options presented in the Joint Committee on Taxation's Description of Possible Options to Increase Revenues. (Page references to specific items are given.)

1. Extend Medicare payroll tax to all state and local government employees. (p. 1)

The proposed requirement to cover all state and local government employees under Medicare is a new federal mandate on state and local governments. It is the policy of GFOA that the federal government should exercise restraint in imposing mandates, but the Association recognizes that some may be necessary to promote important social goals. The GFOA opposes this new Medicare requirement because it fails to provide adequate time for the affected governments to make the necessary resource and administrative accommodations necessary to comply with the mandate. Additionally, under present law, state and local government employees hired after April 1, 1986 are subject to the medicare requirement, so in effect, mandatory medicare is already being phased in and the federal policy objective will be achieved over the next several years.

2. Repeal of current gasohol, bus and state and local government highway excise tax exemptions. (p. 15)

Historically state and local governments and the federal government have reciprocally exempted each other from paying excise taxes. The GFOA has long supported the immunity of state and local government from taxation by the federal government. Under current law the federal government taxes the fuel consumption, truck and tire sales, and highway use of nongovernmental users. Respecting the longstanding doctrine of reciprocal tax immunity state and local governments and the federal government do not levy gasoline, sales, or road use taxes on each other. The proposal to repeal the exemption from federal highway excise taxes of state and local governments is an encroachment by the national government and it imposes a significant financial burden on state and local governments. GFOA opposes this tax on state and local governments.

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* Prepared by Catherine L. Spain, Director, Federal Liaison Center, Government Finance Officers Association, 1750 K Street, NW, Suite 200, Washington, DC 20006, (202/429-2750). Questions or additional information concerning the issues presented in these comments should be directed to Ms. Spain or Cathie Eitelberg, Assistant Director of the Federal Liaison Center.

3. Increase Trust fund excise taxes by an amount to offset implicit general fund contributions. (p. 72)

The proposal is to increase excise taxes that are dedicated to trust funds such as highway, airport and port use taxes. However, instead of making the additional revenues available to the trust fund, they would be retained in general revenues. We are particularly concerned that one of the justifications is that state and local governments are not entitled to receive their fair share of the dedicated tax receipts because the improvements they make to infrastructure facilities for which they are reimbursed with trust fund monies are financed with tax-exempt bonds.

This insidious proposal is a back door attack on the Constitutional right of state and local governments to sell tax-exempt bonds for governmental purposes. Members of Congress must recognize the total disrespect for our Constitution and federal system of government embodied in this proposal and reject not only this specific option but its theoretical underpinning. State and local governments are not abusing their right to issue bonds when they build roads, bridges, airports and ports, nor should tax exemption on the bonds issued for these public purposes be considered a subsidy.

4. Value Added Tax and Business Alternative Minimum Tax (p. 79)

The Government Finance Officers Association believes it is premature to discuss a new consumption tax (a value added tax (VAT) or a business alternative minimum tax) in connection with this year's reconciliation bill. There are many policy issues which need to be discussed relating to the alternative forms of these taxes and the fact that a federal VAT would bring the federal government into a new tax area that previously was used exclusively by states and localities.

5. Securities Transfer Excise Tax (p. 82)

The proposal to tax the transfer of securities (including stocks and bonds) has drawn the attention of the GFOA because of its numerous negative impacts on state and local governments and because its effect on state and local governments would be inconsistent with general principles of intergovernmental immunity. The Association opposes this tax on state and local government securities and state and local government investments subject to the tax because it will

- increase the cost of capital for state and local governments which is needed to build and repair the nation's infrastructure because investors will demand higher interest earnings to compensate for paying the tax,
- skew short-term investment decisions by discouraging public investment officials from actively managing their portfolios in order to avoid taxation, and
- reduce the investment earnings of public employee retirement systems in the securities markets resulting in either increased pension funding costs for state and local government retirement systems or reductions in pension benefits for state and local government workers.

6. Reduction in individual and corporate tax preferences (p. 88)

Although this proposal is not fully developed, we oppose this option at this time because it could potentially cause a great deal of harm to states and localities. Essentially it is suggested that the value of "certain" tax preferences could be reduced by a specific percentage in order to raise revenues. One of several deductions which we believe would be included and whose inclusion we would oppose is the state and local government income and property tax deduction. In addition, any impact of this proposal on state and local governments' ability to borrow must be carefully analyzed before changes are made. The Government Finance Officers Association opposes any proposal which has the potential to reopen, without benefit of debate, many of the issues dealt with during tax reform.

7. Disallow interest deduction allocable to tax-exempt installment sales of property to state or local governments. (p. 149)

The Government Finance Officers Association believes the present system for financing the purchase of equipment by states and localities is the most efficient for all levels of government. States and localities are able to minimize the amount of tax-exempt debt outstanding through installment purchases because the process is less time consuming and it is not necessary to sell debt in the market where higher legal and financing costs are paid. The Association objects to proposals limiting or eliminating the deductibility of interest expenses associated with installment sales because they will result in higher financing costs for state and local governments. Additionally, traditional state and local government leasing practices should not be affected.

8. Alternative Minimum Tax (p. 243)

A basic tenet of the federal system of government is the Constitutional doctrine of reciprocal immunity. Therefore, the federal government cannot tax the interest on obligations issued by state and local governments and state and local governments cannot tax the interest on federal obligations. The proposal to tax the interest earned on "additional" state and local bonds under the individual and corporate alternative minimum taxes would result in the direct taxation of governmental general obligation and revenue bonds. Proposals to increase the alternative minimum tax would affect more severely those bonds that are already subject to taxation as a result of changes in the 1986 Tax Reform Act--changes which our Association is challenging on Constitutional grounds in federal district court with the City of Atlanta as co-plaintiff. GFOA opposes changes in the alternative minimum tax that result in taxation of tax-exempt interest.

July 15, 1987

TO: Chairman and Members of the Committee on Ways and Means
U.S. House of Representatives

FROM: Lee F. Holdmann
9207 Old Georgetown Road
Bethesda, Maryland 20814

I am Lee Holdmann, an attorney specializing in business and individual tax matters and estate planning. My experience extends over 25 years, including service as an Attorney Advisor to the U.S. Tax Court and extensive teaching work in college, corporate-retirement and association education programs. I am testifying today as a private citizen and one familiar with our tax system and several of the tax laws concerning which options are being considered. I do not represent any group or other interest.

May I thank the Chairman and members of the House Ways and Means Committee for this opportunity to participate in the tax legislative process. The present formative stage of the current bill, during which you are receiving oral and written testimony requested from the Treasury Department, from citizens and from the business community, is an all-important critical stage. It is now that the Committee members are sifting through the budget proposal and the options and are weighing the testimony. Hard choices are beginning to be made. The texture, theme and tone of the bill are already taking character.

The work of Congress generally, and your Committee in particular, which resulted in the 1986 Tax Reform Act was most difficult and represented a new era in tax legislation. The swing away from special interests and in favor of a broad-based income tax was an historic event. This momentum toward a sound fiscal and tax system must be continued. It will not be sufficient to simply find the right number and mix of tax options to meet the President's mandate. The time for rubber stamping Treasury Department proposals or bowing to strong pressure from special interests had obviously passed when this Committee's 1986 bill was completed. With work now pending on a 1987 bill, the American people never had a greater need for this Committee to exercise its leadership in a responsible and independent way. The Joint Committee and Ways and Means Committee Staffs' Descriptions of Possible Options to Increase Revenues (Joint Committee on Taxation: Description of Possible Options to Increase Revenues Prepared for the Committee on Ways and Means (JSC-17-87) June 25, 1987, hereafter referred to as "Options") contains the basic material from which you can meet the President's budget proposals and complete the foundation work started last year which could provide tax and fiscal responsibility of which Americans can be proud well into the next century. Clearly, the opportunity has been presented.

In this statement, I will identify some of the important factors which can intrude, often subtly, on the process of creating tax legislation. I will then present materials on four topics with which I have a special familiarity and working knowledge--the consumption or value added tax, (Options p. 75), cash-value life insurance (Options p. 233), the capital gain tax problem (Options p. 240-242) and estate and gift tax items (Options p. 258).

A. Lessons Learned from Past Experiences in Lawmaking

One of the most unfortunate problems which has plagued the tax legislative process in the past thirty-three years, and to some extent since the first U.S. tax law was passed, is the dicotomy between the original intent and purpose of the legislation and the actual result. Time and again we have seen the framers of legislation characterize their bills as tax-simplification, loophole-closing, fair, progressive, popular, effective, etc., only to see their hopes dashed sometimes even before the bills are signed by the President. Then there is the problem of tax planning which often sidesteps the brunt of the law, or creates new and larger loopholes which have to be addressed anew. We have seen in recent years that public confidence in the tax system and in the methods used by the Internal Revenue Service has been gradually but consistently eroding to the point where it is now common knowledge that the effect of most laws can be avoided or blunted by good tax counsel and transaction planning. An example of this is the recent exchange planning for real estate investments which has gutted much of the intended revenue effect of the 1986 capital gain rate changes less than one year after passage of the law. A change in the like-kind-exchange rules to exclude real estate has been suggested as a possible proposal (Options p. 240) but would face several problems and, if enacted, would encourage more searching for loopholes. More to the point is the possible proposal to reduce the maximum capital gain rate to 15 percent (Options p. 242). Finally there is the widespread problem of noncompliance by those who have chosen and been able to evade the payment of taxes they owe. As discussed below, the Treasury Department's approach to this problem is to expand the adversary (battle) ammunition. U.S. Treasury Tax Legislative Counsel, Dennis E. Ross, in his statement to this Committee on July 7, 1987, at p. 17, said that the increased funding for the Internal Revenue Service in the Administration's proposal would result in a revenue impact which "will increase receipts in the 1988 fiscal year by $2.4 billion." Even if we could accept the Administration and Treasury premise that we should continue to deal with the noncompliance problems by increasing government staffing at the Internal Revenue Service, Mr. Ross's figures are wrong. The immediate revenue impact estimate is $2.1 billion, not $2.4 billion. The Administration estimated the additional funding "to increase taxes collected in 1988 by $2.4 billion at a cost of about $300 million." (President's Fiscal Year 1988 Budget contained in Budget of the United States Government, 1988 at p. 5-154.)

Inherent in this general problem relating to the gap between the expected and the real effect of tax legislation are several factors which can perhaps by now be called lessons. These include the following:

1. Where law changes are made with the intent of closing loopholes, but which are adjustments to a complicated code structure which has had a series of perceived loophole closings in the past, it is likely that new loopholes will be found to defeat the intended revenue effect of those law changes.

2. The adversary process which is inherent in the U.S. legal system should be tempered in the tax legislative process if it has become destructive or counterproductive. This is especially so if there are alternative methods available to collect taxes without perpetuating the seige mentality and battle-ground posturing. Examples of these excesses on the taxpayers' side are the bloated fees and administrative costs involved in tax planning and tax compliance, over-aggressive planning which can verge on the borders of tax evasion and tax fraud, loss of confidence of the vast majority of taxpayers who pay taxes without question or delay. Examples of the government going to excesses are well known. One of the less obvious excesses is the constant use of charged buzz words when the Treasury Department is seeking to have Congress pass one of its revenue-raising proposals. Some of these buzz words were used by Mr. Ross in his July 7, 1987, presentation--viz. "tax avoidance," "tax-avoidance device," "artificiality." Others such as "shelters" and "loopholes" are also seen frequently. This tactic is certainly good advocacy but not appropriate in the legislative process where it can impede thoughtful and careful analysis. Congress is the reflective branch of government and does not have to be drawn into the more reactive, front-line type decisions required of the executive branch and its Treasury Department.

   The time might be right for this Committee to inaugurate a new tax system in the United States--the value added tax. Doing so would remove excesses of the adversary process in several respects. First it would resolve the potential conflict for the Treasury Department which did not and perhaps cannot recommend a value added tax because it may be inimical to tens of thousand of jobs at the Treasury Department and Internal Revenue Service which will not be needed if the European countries' experiences can be relied on. Second, adoption of an effective value added tax will provide substantial revenues without the adversary conflicts and financial burdens to society which have become part of the income tax system. Finally, it can represent a simple alternative to assure that the cost of government is borne by everyone, including those who have been able to evade the income tax laws. (See discussion below.)

3. Tax bills to raise specific amounts of revenues under mandates and deadlines set by the Administration are prone to inadequate consideration and often become quick fixes which are bad tax laws. They usually end up being more costly than if they had not been passed in the first place. For example, they create perceptions in the public that the tax system is unfair; they do not in fact generate the taxes they were intended to generate; and they cause deficits or budgetary problems in the future.

B. The Value Added Tax ("VAT")

I strongly favor this proposal and urge the Committee to take immediate steps to draft a VAT or general consumption tax bill. In addition to the excellent analysis provided for this Committee on July 7, 1987, by Mr. Paul R. Huard on behalf of the National Association of Manufacturers (p. 10), I would like to add the following considerations:

1. In the last six years I have read extensively on the VAT systems of England, Switzerland, Denmark and Germany and I have had occasion to discuss several of the VAT systems with tax administrators, private tax practitioners, economists, business persons, and citizens of these countries. Without exception the experiences of those persons I talked to was in effect "it is a tax; it is perceived as a tax and to that extent is seen as the government's expecting from its citizens their contribution to the cost of government. It works efficiently because it enforces itself and has very little opportunity for tax evasion. It requires significantly fewer personnel and less administrative cost for the government than the income tax." We Americans should not be put off by the strange concepts or unfamiliar terminology used in VAT jurisdictions.

2. A general consumption tax in the U.S. is now supported by respected economists, political observers of liberal and conservative persuasion and by businesses in America.

3. A VAT system can be set up in a way that can provide zero-tax rates or exemptions for certain goods or services to minimize regressivity.

4. The VAT system can be easily monitored and adjusted as to rates to achieve desired objectives. Probably it will be best to institute the VAT at higher, rather than lower, rates. It appears to be the experience of some European countries that raising the VAT rate after it was instituted created special problems of public acceptance.

5. A government instituted educational program for businesses and the public must be established and carefully implemented.

6. The VAT system should apply the same rate to virtually all goods and services. The system should not attempt to apply higher or lower rates for certain items to discourage or encourage consumption.

7. The invoice method of record keeping should be used. It will probably lend itself today to computer processing control by most companies.

8. The VAT should be separately stated in an invoice even at the retail level so that it will not risk becoming a hidden tax.

9. The VAT should exempt exports but tax imports. Thus U.S. businesses will achieve opportunities in international trade which they do not now have.

10. An efficient VAT will minimize the need not only for government tax administration employees but also for tax planning professionals.

C. Cash-Value Life Insurance--Option to Tax Growth or Inside Build-up

In April and May of 1987, my office conducted a survey on a bill we anticipated would be proposed to tax the inside build-up of life insurance policies. The survey was sent to approximately 200 people who we felt represented a cross section of society including persons from all walks of life, fields and professions. Thirty-three responses were received. Twenty-two opposed the taxation of inside build-up, five were in favor of the tax and six expressed no opinion.

Excerpts from the survey are quoted below followed by comments of the respondents. We included all relevant comments omitting only those which were unintelligible or unresponsive. Almost all of the respondents included their names and addresses. We will be glad to provide the originals of all survey responses if the Chairman desires.

1. The Survey

The survey read as follows:

"LIFE INSURANCE TAX BILL SURVEY

It is anticipated that a bill will be proposed in Congress to tax the "inside build-up" of life insurance--that is, the annual yield on or growth in value of life insurance policy cash values. Please share your views with us.

1. Do you favor a law change which would result in the current taxation of the inside build-up of life insurance policies?

   YES ( )
   NO ( )
   DON'T KNOW ( )

2. Please state the major reason or reasons for your position:

   ____
   ____
   ____
   ____
   ____

3. **Do you see any major argument against or objection to your position?**

   YES ( )
   NO ( )

   If "YES", please state what it is:

   ____
   ____"

2. Reasons Given for Opposition to the Law Change.

Of those 22 opposing a law change, comments identifying the major reason or reasons for the opposition included the following:

- "I resent paying tax on money I haven't received, and may never receive if the policy continues in force until death." (Retired Electrical Engineer and Engineering Executive)

- "Impossible to plan financially if the rules keep changing after you're committed to a plan of action." (Executive and Business Owner)

- Present law "encourages purchase of life insurance on a long term basis so that the insurance will be in force when needed, i.e., at death." (Pension Actuary and Life Insurance Broker)

- "The cash value . . . should not be taxed until received as an actual disbursement. The security provided for survivors has been paid for with after tax dollars anyway." (Insurance Agent)

- "Taxing inside cash value buildup would be equivalent to taxing the equity increase in the appreciation of a home." (Financial Planner)

- "Life Insurance is to help pay debts when someone dies and should not be taxed." (Real Estate Broker and Developer)

- "What will stop them from charging us a buildup on equity of our house -- or on our stock, etc??" (Education)

- "Because this type of investment is one of the last retirement, estate-growth avenues left to the middle class. If we are not allowed to save for our future, the government will in fact be forced to increase forever the social security payouts." (General Contractor-Residential; Wife-Administration)

- "We have had far toooo much tax legislation during the past 10 years. Get Congress to reduce their expenses and budget." (Insurance)

- "The majority of insurance coverage is taken out for payment as a death benefit and not annuity or growth and thus . . . should go to the beneficiaries--not the government." (Formerly Government Procurement Official--Now Retired in Florida--and Homemaker)

- "A change in the law would adversly affect the elderly who have already suffered from the removal of various tax benefits by the TRA '86." (Lawyer)

- "Constant change makes it impossible for an individual to plan his/her financial program." (Chemical Engineer, Research on Fuels)

- "This may be one of the last ways to build equity for those in modest or fairly modest circumstances." (Retired Career Employee in Heavy Construction Corporation, Comptroller and Administrator of Insurance and Health Benefits)

- "It could discourage the procuring of insurance . . . . Insurance benefits the community, as well as the family." (Government Attorney)

3. Opponents' Identification of Objections to Their Positions

Those opposing the law change identified major arguments against or objections to their positions. These included the following:

- "Desire to raise additional tax revenue." (Teacher)

- "Tax free build-up tends to favor the affluent. This argument is spurious since substantial amounts of permanent life insurance are owned by middle 'America'" (Pension Actuary and Life Insurance Broker)

- "One less revenue source when they need to find more." (Corporate Chairman)

- "Some insurance companies are trying to make the insurance contract an investment contract and the government wants to close what they see as a tax loophole. In reality, insurance contracts are simply vehicles used to provide the necessary security to the family by providing immediate death benefits and long term income benefits on a conservative basis." (Financial Planner)

- "The government's hunger for more taxes is a short-sighted effort not to cut the budget instead of increasing taxes." (General Contractor-Residential; Wife-Administrator)

- "Too many liberals want to spend." (Insurance)

- "It is a 'money grab' by the IRS and the Congress. The entire sum realized from the proposed tax could not possibly amount to more than a couple of hundred million per year, but can cause considerable hardship in individual situations." (Formerly Government Procurement Official-Now Retired in Florida)

- "The gross abuse of the inside build-up by insurance company's in single premium products arguably should be punished (but this would hurt society)." (Life Insurance Sales)

- "It could . . . be considered a form of discrimination against other investments which are taxable." (Government Attorney)

4. Reasons Given for Support of the Law Change

Of those favoring a law change, comments identifying the major reason or reasons for the position included the following:

- "Favors one type of investment over another and insurance companies without any social or economic gain to society." (Manager Strategic/Financial Planning--Now Retired)
- "I don't see the justification for exemption from taxation. I believe it is more fair to lower all taxes than to provide a special exemption for one kind of investment." (Retired Economist U.S. State Department)
- "Insurance policy income should be taxed annually or at time of death like other forms of investments. Why special exemption for insurance? Loophole without any economic, social or policy argument." (Retired Federal Economist and Administrator)
- "I see no valid reason for it to have special tax treatment. I compare it to zero coupon bonds which were an abuse to the system until the law was changed." (Lawyer for Justice Department--Now Retired)

5. Supporters' Identification of Objections to Their Positions

Those favoring the law change identified major arguments against or objections to their positions. These included the following:

- "All taxpayers looking for a legal tax break." (Retired Economist--U.S. State Department)
- "Power of the insurance lobby, their lawyers and the privileged rich." (Retired Federal Economist and Administrator)

D. Capital Gain Tax Problem

I favor a reduction of the maximum long-term capital gain rate to 15%. The increase of the maximum capital gain tax rate to 28% in the 1986 TRA resulted in a rush of sales prior to the effective date of the new law and a slow down in sales since then. Many now perceive that the law change was a mistake. The damage is not only the loss of anticipated revenues but an unfortunate stagnating in the turnover of capital investment assets. Also new, creative planning techniques are being devised to circumvent the effect of the higher rate.

Three options have been suggested -- repeal of the step-up in basis at death; removal of real estate from the exchange rules; and a 15% capital gain rate. These will be considered in order.

1. Repeal of Step-up in Basis

Carryover basis at death is wrong for all the reasons it was wrong when tried in 1976. At that time too it was thought to be a good idea. Then, as the administrative burdens and added costs of expert professional counsel and recordkeeping became apparent, Congress wisely repealed the carryover basis rules. Another reason why it would be a mistake to adopt carryover basis rules for deathtime transfers is that the very recent realization of problems in the new capital gain rates has resulted in a last-minute search for options to try to salvage rather than scrap a bad law. Carryover basis with its complexities and far-reaching implications, having been found once in recent memory to be a mistake, would need considerable study and work before it could realistically be proposed as legislation.

A capital gain tax at death would be wrong because it would be more dramatic and traumatic than carryover basis and have no study or experience as a guide. Moreover a capital gain tax at death, coming on top of estate taxes, inheritance taxes and administration and funeral expenses, would be particularly cutting. It would be a tax on phantom income or phantom gain. That is, the property is not sold; it continues to be held by the widow or children. There will likely be no intent or wish to sell. Yet this option proposes to tax the gain even if there is no cash to cover the tax. This tax on phantom gain would come at a time when the cash needs are heavy, when the property owner has just died, and when the surviving beneficiaries may not know how to market the property.

2. Removal of Real Estate from Exchange Rules

The exchange rules should not be altered. They are complex and serve a useful purpose permitting a person to acquire a replacement property without having to recognize a gain. These rules have been more talked and written about than used in recent years because other provisions of the Internal Revenue Code inhibited their usefulness. There are various mechanical rules to be followed in an exchange and an exchange would always dilute the benefits of depreciation deductions. Also, the capital gain rate was substantially lower than the ordinary income rate. Thus taxpayers were more inclined to sell the property and recognize the gain.

3. Fifteen Percent Capital Gain Rate

A return to the lower capital gain rate -- possibly as early as this summer -- will stimulate sales and the corresponding capital gain taxes. We favor the 15% rate for capital gains as a workable and beneficial resolution of the problem.

E. Estate and Gift Tax Items

1. Changing Credit to Lower Exemption Level

I recommend that no change be made here. The existing credit level was carefully worked out by Congress. It would only cause confusion for the Internal Revenue Service and the public if Congress recarted on the law passed in 1981.

2. Subjecting Life Insurance Not Owned by a Decedent to Estate Taxes

A tax at death on life insurance not owned by a decedent would be contrary to all common sense and concepts of fairness and equity. The law does not tax other property not owned by a decedent. Besides most life insurance which is not owned by the insured is owned by spouses today and is 100% marital-deduction property. Subjecting spousal-owned life insurance to estate taxes would have absolutely no revenue effect for the U.S. Treasury or for the family.

3. Repealing "Crummey" Rule

Eliminating the Crummey case annual exclusion would not likely have any beneficial effect. If adopted it would overrule existing case law and customary practice which has been in place for irrevocable trusts. There would be a difficult if not insoluble problem of how to treat old "Crummey" trust which still enjoy the benefit. Annual exclusions for gifts to trusts have been provided in the law for a long time. See for example IRC Section 2503(c).

4. Freezing Maximum Estate Tax Rate at 55%; Increasing the Maximum Rate for Some Higher Level (e.g. 65% on $10 Million); Two Percent Minimum Estate Tax

We oppose these options for the reason that they are contrary to the Government's policy of reducing tax rates. In addition, these changes would introduce complexity into the law, increase the burden of the Government's and the public's compliance costs and discourage wealthy persons from living in the United States.

5. Flat-rate Gift and Estate Tax

We support the flat-rate 50% tax provided no other changes are made to the credit, step-up in basis at death, or other existing gift and estate tax rules. The flat-rate tax at 50% will simplify the tax structure, generate additional taxes and encourage persons to live (and accordingly die) in the U.S.. Although this option will increase the tax for all taxable estates this is not objectionable in light of the simplification and ease of administration which will result.

Thank You

Lee F. Holdmann
9207 Old Georgetown Road
Bethesda, Maryland 20814
Home Tel. (301) 530-1156 or
(301) 530-5182
Bus. Tel. 530-0900

STATEMENT OF
THE INTERNATIONAL COUNCIL OF SHOPPING CENTERS

ON THE
DESCRIPTION OF POSSIBLE OPTIONS
TO INCREASE REVENUES

PREPARED FOR THE
COMMITTEE ON WAYS AND MEANS

INTRODUCTION

My name is Wallace R. Woodbury. I am Chairman of the Board of Woodbury Corporation, Salt Lake City, Utah, a long-established real estate development, brokerage, management and consulting firm. I am also Chairman of the Tax Subcommittee of the Government Affairs Committee of the International Council of Shopping Centers (ICSC), and I submit this testimony today on behalf of the members of ICSC.

The International Council of Shopping Centers is the trade association for the shopping center industry with over 21,000 members. Membership includes developers, owners, retailers, lenders and all others having a professional interest in the shopping center industry. ICSC members represent most of the 28,500 shopping centers in the United States. In 1986 these centers generated $20.3 billion in sales tax revenues and employed 6.9 million people.

The "Description of Possible Options to Increase Revenues" prepared by the staff of the Joint Committee on Taxation and the staff of the Committee on Ways and Means contains numerous provisions that concern the members of ICSC. The real estate and shopping center industries are concerned that many of the proposals would inappropriately reduce investment in real estate and decrease the ability of shopping centers and retailers to adequately serve the needs of consumers. It is important that the consequences to the shopping center industry of future tax policy changes contained in the proposals be carefully considered.

(1) VALUE ADDED TAX

Proposal

Present law does not provide for a federal sales tax. The proposal imposes a new value added tax (VAT) which is the economic equivalent of a tax at each stage of production. A value added tax is a sales tax imposed on the value added to goods and services by each business.

Two types of VATs are proposed. The first is modeled after the VAT used in Europe whereby each business calculates the tax based on its sales and is permitted a credit for the VAT already imposed on its purchases. The second type is referred to as a business alternative minimum tax (BAMT). This tax is imposed on the difference between a business' receipts and expenses. Under the BAMT, deductions are granted for the employer-paid portion of the social security tax (FICA), one-half of a self-employed individual's social security tax (SECA) and a business' net operating losses.

ICSC Position

ICSC opposes the imposition of a value added tax. Shopping centers account for more than one-half of the retail sales in the U.S. (excluding automobile sales). As the proposal states, a VAT is the "economic equivalent of a retail sales tax," and a 5% VAT would approximately double the sales tax imposed by most states. This would reduce retail sales, adversely affecting employment and the economy generally and shopping centers in particular, and ultimately reducing the federal tax revenues.

Another defect of a VAT is that, like all sales taxes, it is regressive. It also would establish a completely new system of federal taxation, and would impinge on a source of revenue that has traditionally been reserved to the states.

(2) REDUCTION IN INDIVIDUAL AND CORPORATE TAX PREFERENCES

Proposal

Exclusions, credits, deductions, and deferrals of tax liability provide economic incentives to the private sector, tax relief to certain taxpayers, and are necessary to measure the "net" income to which the federal tax applies. The pamphlet proposes to reduce certain of these "preferences" by either 10% or 20% for purposes of both the regular income tax and the alternative minimum tax "AMT." Items of deferral (e.g., accelerated depreciation) would be permitted only to the extent of a certain percentage of the item involved. Among the preference items cited for possible percentage reduction are "accelerated" depreciation, itemized deductions for individuals, ITC, business and travel expenses. The description also proposes to increase the AMT rate.

ICSC Position

ICSC opposes the proposed reductions in certain tax preferences. Congress has eschewed a gross income tax for the reason that gross income does not realistically measure real income. The production of income necessarily involves expenditures on the part of taxpayers, and these expenditures should be fully accounted for in measuring taxable income.

Reducing depreciation deductions by 10% further exacerbates the insufficient 31.5 year straight-line recovery period for non-residential real property. Denying taxpayers 10% of their depreciation deduction effectively extends the recovery period for non-residential real property to 35 years while a 1973 study of actual depreciation rates of shopping centers showed an average life of 25 years with a range of 22 to 29 years. Other legitimate expenses that are incurred for the production of income, such as travel costs, also would be inappropriately limited. The current AMT already prevents taxpayers from taking full advantage of certain tax preferences.

(3) LIMITATIONS ON THE DEDUCTIBILITY OF ADVERTISING COSTS

Proposal

The proposal would treat advertising expenses not as ordinary and necessary business expenses that are currently deductible, but rather as capital expenditures that must be amortized, at least in part, over a period of years. The proposal would require 4-year amortization of 20% of advertising expenditures or, for firms with over $5 million in gross receipts, permanently deny a deduction for 20% of the expenditures and require the remaining 80% to be amortized over 2 years.

ICSC Position

ICSC opposes any limitations on the deductibility of advertising expenses. Such limitations will discourage advertising, resulting in a reduction in sales and a consequent ultimate diminution of federal and state tax revenues.

Shopping centers have been economic successes primarily because many businesses compete to provide the best and least expensive goods and services, in close proximity to one another, strongly facilitating the benefits of a free market economy to consumers. Businesses advertise to inform customers of the way they compete in providing their goods and services. A reduction in advertising will result in a reduction of competition.

In addition, shopping centers are major locations for new and small businesses due to the availability and relative affordability of retail space. These businesses rely heavily on advertising to establish themselves as viable entitites in the market. New businesses necessarily advertise heavily in their first year need to deduct this expense in that year in order to avoid financial hardships. This proposal would be particularly unfair to small business because it would act as an impediment to the success of smaller, lesser-known enterprises.

Congress should also be aware that all advertising expenditures are not for the same purpose and do not produce the same benefits. Price advertisements that announce short-term sales or product availability attempt to match buyers with sellers and establish supply-demand adjustments in the short-run. Such advertisements are heavily used by retailers in shopping centers, have short-term impact, and should be currently deductible.

(4) INSTALLMENT SALES

Proposal

Under present law, enacted last year by the Tax Reform Act, dealer sales of real property and sales of real property for over $150,000 (which includes virtually all shopping centers) used in the taxpayer's trade or business or held for the production income are subject to the "proportionate disallowance rule." This rule requires the taxpayer to treat a portion of the installment obligation calculated by a complicated formula (the amount of the obligation multiplied by his total debt to asset ratio) as a payment on the installment obligation.

The proposal would completely repeal installment sales treatment for taxpayers subject to the proportionate disallowance rule as well as for all sales by dealers.

ICSC Position

ICSC opposes the installment sales proposal and urges Congress instead to repeal the installment sales provisions of the Tax Reform Act of 1986 (TRA '86).

The installment sales rules were originally enacted to ensure that sellers pay tax on sales proceeds only as the proceeds were received. Congress recognized that taxpayers engaging in installment sales may lack the liquidity to pay the tax on the entire gain from the sale. TRA '86 essentially repealed the tax benefits from the installment sales rules for many taxpayers. The proportionate disallowance rule is a significant restriction on installment sales and fails to accurately measure income for tax purposes or any other financial purpose.

Non-dealers in commercial real estate and business property should be subject to the installment sales rules of prior law which would allow them to treat installment sales payments as income only when those payments are received. It is unreasonable to create a situation where the tax liability in the year of a sale may exceed the cash received by the seller in the transaction. This change would reestablish seller financing as an available method of selling business and investment property, a method that often is the only means available, particularly in periods of high interest rates. Installment sales are traditionally used by new entrants in the shopping center business that find it difficult or impossible to obtain commercial financing. Since businesses involving substantial real estate operations traditionally have large amounts of debt in relation to assets, individuals involved in the sale of shopping centers are unfairly burdened by the proportionate disallowance rule, penalizing taxpayers because of extrinsic debt totally unrelated to the transaction.

Because installment sales treatment does not eliminate ultimate tax liability, neither the TRA '86 changes nor the reinstatement of pre-TRA '86 law affect the total amount of tax paid. The timing of the payment of that tax is important, however, and it is unfair to require the payment on a tax in excess of the cash received on a sale. Inability to pay the tax in many cases will prevent the sale and reduce federal revenues.

(5) PARTNERSHIP PROVISIONS

Proposals

Master limited partnerships ("MLPs") are limited partnerships the interests of which are publicly traded or offered. MLPs are classified as partnerships pursuant to the characteristics set forth in the Treasury regulations distinguishing partnerships from corporations. One proposal would treat MLPs as corporations for federal tax purposes. Another proposal would treat MLPs and all limited partnerships as corporations for AMT purposes but not for regular income tax purposes. In addition, net income from MLPs would be deemed portfolio income rather than passive income, and MLPs would be prevented from passing through tax losses, deductions or credits to limited partners.

Another proposal would prevent the pass-through of tax losses, deductions or credits to limited partners in all limited partnerships. Net income would be taxed only at the partner level, and would be classified as portfolio rather than passive income in the hands of the partners.

ICSC Position

ICSC opposes these proposals to radically alter the taxation of partnerships.

Businesses engaged in the development or ownership of real estate typically are conducted in the limited partnership form, principally because it allows different groups of partners to own and operate different properties, and because it provides the partners the flexibility to distribute partnership items in accordance with their contributions to the enterprise. In addition, the ability to offset losses from one real estate venture against another permits developers and owners to spread and moderate the risks that are necessarily involved in developing and operating commercial real estate.

The proposal to prohibit limited partnerships from passing through tax losses, deductions and credits is flawed for reasons of both tax and economic policy. The proposal is poor tax policy because it treats a partner's partnership net income as *per se* taxable but fails to consider real losses from other partnership businesses in arriving at the partner's real net income (i.e., his change in net worth) for tax purposes.

The proposal also would adversely affect the level of new business formation in the United States. Development of shopping centers is an inherently risky business. Some centers are enormously successful while others fail spectacularly. Many developers will invest (or will be permitted to invest by lenders) in a risky project only if the losses attributable to the risky venture can be offset against the income from healthy projects. Prohibiting partnerships from passing through losses will substantially inhibit developers from commencing risky investments or attempting to "turn around" distressed shopping centers.

The formation of new small business will also be stunted if losses are "bottled-up" in the partnership since owners may have tax liability in spite of the fact they may have suffered economic losses and out-of-pocket expenses for the taxable year. Without the ability to offset income with their losses, investors will hesitate to invest in new entities. Start ups of small businesses are the most risky of ventures, but the most productive of job producers, and their development and the introduction of new players will be curtailed by provisions such as this which limit new capital investment.

Characterizing limited partnership income as portfolio income would result in the taxation of a partner's income-producing properties but would effectively treat losses as nondeductible. This amounts to a tax on "gross" rather than "net" income and would be a further unjustified blow to the real estate industry when viewed in conjunction with the unfair characterization by TRA '86 of all rental real estate activities as passive regardless of the degree of participation by the taxpayer. In addition to rejecting this proposal, ICSC believes that Congress would be well advised to revise the treatment of rental real estate as conclusively passive by permitting materially active participants to deduct business losses in a manner similar to that allowed other taxpayers.

The proposal to tax MLPs as corporations also would have substantial negative effects on the real estate industry. A partnership level tax would lower yields to investors and reduce capital investment in real estate. Congress should not make a bad policy worse by extending the economic disincentives associated with the corporate two-level tax structure to partnerships.

(6) RECOVERY PERIOD DETERMINED BY REFERENCE TO 125% OF LEASE TERM

Proposal

The present tax law assigns recovery periods to property for depreciation purposes. The proposal would provide special recovery periods for leased property, equal to the longer of 125% of the lease term (including renewal options) or the recovery period otherwise applicable.

ICSC Position

ICSC opposes establishing recovery periods for leased property by reference to the term of the lease. The proposal ignores the fact that the true economic life of an asset remains the same whether it is owned or leased. This will result in substantially different recovery periods for identical properties. The negotiated duration and price of shopping center leases considers not only the use of the structure but also the long-term acquisition of an attractive commercial location and the long-term business relationship among shopping center tenants.

Long-term shopping center leases involving major retailers confer residual value to both the tenant and the lessor. Inducing a major retailer to join a shopping center enables the lessor to more readily attract commercial financing as well as smaller tenants.

The major retailer, on the other hand, seeks to secure an attractive business location for an extended period. Any renewal options included in the lease represent a retailer's desire to preserve its location and participation in the successful "tenant mix" created by the developer to attract shoppers to the center. The lease also gives the major retailer the option to abandon unsuccessful sites at a minimum cost.

An option to renew is by nature unilateral. If by hindsight a tenant determines the option to have economic value, whether due to increased land value or interim remodeling and capital expenditures or otherwise, optionee will exercise without regard to whether the original improvement has any substantial residual value. Consequently, renewal options are not reflective of the economic life of improvements.

All long-term tenants in shopping centers expect that their facility will be substantially remodeled at least every 10 years. This remodeling is necessary in order for the retailer to compete effectively with businesses located in new, modern facilities and with others who remodel to remain competitive in attracting customers. Both parties envision that substantial reinvestment will be required on the roof, air conditioning, and elevator systems as they wear out, and in both the interior and the shell of the building in order to maintain the shopping center's commercial attractiveness. Thus, the renewal option is not a judgment by the tenant that the original structure will retain its value over that period, but an effort by the tenant to secure a desirable business location and commercial relationships over the long term. The lease term and options for renewal, therefore, do not bear any correlation to the commercially economic useful life of the structure.

Studies conducted for ICSC by Touche Ross indicate that the average useful life of a shopping center structure is 25 years with a range from 22 to 29 years. Therefore, the current recovery period of 31.5 straight-line years for nonresidential real estate is inadequate to allow the full recovery of the capital invested during the economic life of the improvements and imposes a tax on capital rather than income. These impacts would be exacerbated by establishing the recovery period by reference to a lease term and renewal options which bear no correlation to the structure's useful life and which could produce a depreciation period which far exceeds the real economic life of the property.

(7) LIKE-KIND EXCHANGES

Proposal

Present law provides that no gain or loss is recognized if property held for use in the taxpayer's trade or business (or property held for investment purposes) is exchanged solely for property of a like-kind that will also be held for business (or investment) purposes. Deferred exchanges may occur, subject to limitations, provided the exchange property be designated within 45 days and the exchange be completed within 180 days following the date of the original transfer.

The proposal would deny like-kind exchange treatment for real estate. Alternatively, the proposal would narrow the types of property that would qualify as like-kind for tax-deferred exchange by considering similar use of property rather than ownership classification. Another alternative proposal would require that all like-kind exchanges must be made simultaneously.

ICSC Position

ICSC opposes the like-kind exchange proposals because they are inconsistent with basic tax policy considerations, are unfair to the real estate industry, would lock-in properties, and would substantially inhibit the flow of real estate capital.

Like-kind exchange nonrecognition treatment is justified because taxpayers remain in the same economic position after the exchange. The taxpayer has not changed the form of his investment or received cash. The non-taxable exchange of appreciated property for like-kind property also encourages the mobility of capital investment and has facilitated the development of real property.

The elimination of like-kind nonrecognition treatment for real estate will adversely impact a dynamic industry where successful developers and owners frequently enter into new real estate ventures via like-kind exchanges. The proposal would encourage taxpayers to refrain from disposing of appreciated real property in order to postpone taxation. Inhibiting the flow of real estate capital will result in fewer taxable transactions.

Real estate that is used in a taxpayer's trade or business or held for investment takes many different forms. For instance, shopping centers, industrial parks, office buildings, residential rental units, and undeveloped land may be involved with the same investment motivations. The ability to engage in a like-kind exchange with such properties often facilitates new economic development.

Another proposal would narrow the class of real property qualifying for nonrecognition under like-kind exchange provisions by extending the "similar or related in service or use" standard to such exchanges. This standard, for example, could be interpreted to prevent a nontaxable exchange of a shopping center for a mixed-use shopping center/office building, or to preclude the exchange of a small "strip" shopping center for a regional mall. Economically equivalent real estate is held in many different forms and the similar or related in service or use standard is too narrow for such property. This proposal would reinstate narrow criteria similar to those formerly, but no longer, applicable to reinvestment of condemnation proceeds.

(8) INDIVIDUAL CAPITAL GAINS

Proposal

The proposal would provide a maximum tax of 15% on net capital gains.

ICSC Position

ICSC supports the proposal to reduce the capital gains tax rate for all taxpayers. This proposal would promote economic growth and essentially restore the capital gains tax to the effective rate that existed before TRA '86.

Prior to TRA '86, taxpayers paid a capital gains tax that in many cases ranged from 12% to 18%. This resulted from the fact that most taxpayers were not in the 50% tax bracket. Thus, for example, the 60% exclusion for long-term capital gains allowed taxpayers in the 40% tax bracket to pay a capital gains tax of approximately 16%. This proposal would effectively restore the capital gains tax rate to pre-1987 levels.

A lower tax rate for capital gains would encourage the sale of assets so that capital can flow to new enterprises and industry. Taxable transactions and, therefore, tax revenues also would increase as taxpayers would seek to realize the gain on their investments in light of the lower level of taxation. While some argue otherwise, the historical record seems to endorse ICSC's position that lowering the capital gains rate would, in fact, increase revenues by motivating substantially increased taxable transactions.

(10) ALTERNATIVE MINIMUM TAX

Proposal

The proposal would increase the alternative minimum tax (AMT) rate from 21% to 25%. In addition to the rate increase, the proposal would add a number of new preferences to the minimum tax.

ICSC Position

ICSC opposes both an AMT rate increase and an expansion of the AMT preference items.

The AMT is an attempt to insure that taxpayers do not take undue advantage of deductions, credits, and losses permitted in the tax code in order to totally avoid paying income taxes. It is important to bear in mind, however, that the federal income tax does not tax "gross" income but rather permits deductions so that there is a tax on "net" income only. Expanding the number of tax "preferences" for purposes of the AMT serves to create a system that imposes a tax on gross rather than net income.

The proposal takes another large step in the direction of replacing the regular income tax with the AMT because of the proximity of the proposed 25 percent AMT rate and the 28 percent top regular tax rate. These changes will result in fewer taxpayers paying taxes under the regular tax system, and further distort the impact of regular tax deductions on taxpayer's basis in property.

Tax preferences are enacted by Congress to promote certain useful economic or social purposes. The incentives provided by these preferences will be undermined by an AMT rate increase.

(11) REPEAL OF THE "STEPPED-UP BASIS" RULE

Proposal

The basis of property acquired from a decedent is the fair market value of such property at the date of death. This is referred to as the "stepped-up basis" rule because survivors increase the basis of property by the amount of appreciation of the property while held by the decedent. Appreciated values are used in determining estate tax liability.

The proposal would impose an income tax on the net appreciation of a decedent's property passing upon his death. Property that passes to a spouse or charity, however, would not be subject to the appreciation tax but rather would receive a carryover basis equal to the decedent's basis.

ICSC Position

ICSC opposes both the imposition of income tax on appreciation at death and repeal of the existing stepped-up basis rule.

The unit of taxation in this context should be the family and not the individual, and the death of the named owner should not trigger taxation. An income tax at death measured by appreciation would not only require unavailable liquidity in the estate, but would substantially increase the total taxes on assets passing from one generation to another, and preclude the continuation of many small businesses, including many family-run shopping center development and operation firms.

This proposal also would require taxpayers to maintain detailed and complicated records over long periods of time in order to accurately determine the bases of assets. Not only will taxpayers find this difficult and burdensome in the years ahead, but taxpayers do not have these records for property they currently own since there was no need to keep such records under existing law.

STATEMENT OF

WILLIAM R. HOWELL

ON BEHALF OF

THE RETAIL TAX COMMITTEE OF COMMON INTEREST

SUBMITTED TO

THE COMMITTEE ON WAYS AND MEANS

U.S. HOUSE OF REPRESENTATIVES

"Revenue Increase Options"

July 15, 1987

* * * * * * *

Introduction

I am William R. Howell, Chairman of the Board and Chief Executive Officer of the J. C. Penney Company, Inc. I am presenting this statement on behalf of the ten general merchandise retailing companies and two major retail trade associations which are members of the Retail Tax Committee of Common Interest, who have worked cooperatively on federal tax policy issues for approximately ten years. A list of our members is attached.

This statement is presented to the Committee to urge that your consideration of potential tax increases needed to meet the FY 1988 budget reconciliation requirements exclude those options which would undermine the significant contribution that the Tax Reform Act of 1986 (the 1986 Act) made toward a more efficient and equitable federal income tax system. Specifically, we urge that the individual and corporate income tax rate reductions be allowed to go into effect as enacted without delay or revisions. Our support for full implementation of these rate reductions includes opposition to a surtax or any other proposal which would increase tax rates in less visible ways. Increasing tax rates would not only break an explicit understanding between the Congress and taxpayers, it would also provide a powerful argument for those who would seek to reinstate special provisions which were repealed or limited in conjunction with rate reductions last year.

We also urge that other options, including limitations on the deductibility of advertising costs, increases in the tax costs of maintaining pension plans and providing certain other benefits to employees, imposition of certain new excise taxes, restrictions on or repeal of the LIFO method of accounting for inventories, and increases in FUTA taxes, each of which would adversely impact our already high tax burdens, be set aside. Finally, we recommend that major new tax systems not be considered in the context of FY 1988 reconciliation legislation.

These comments are limited to those options discussed in the revenue options pamphlet, issued by the staff of the Joint Committee on Taxation on June 25, 1987, which would have a negative impact on the retailing industry. With the exception of the comments concerning preservation of the scheduled rate reductions, which we view as of primary importance, the order in which these comments discuss particular revenue options is not intended to reflect the relative priority of each of the options for members of the Retail Tax Committee.

The Retail Tax Committee's views on these matters are based on our strong conviction that the 1986 Act as a whole should be given the opportunity to carry out its objective of reducing the pervasive and disruptive influence which the prior combination of high tax rates and numerous special provisions had on economic and financial decisions. Although the 1986 Act was not perfect, its long-term economic benefits are likely to be substantial, provided that its principal features are not altered. We believe that those features are (1) the dramatic reductions in nominal tax rates for both individuals and corporations, and (2) the significant lessening of the disparities in effective tax rates among corporate taxpayers with similar financial or economic incomes.

I. Full Implementation Of The Income Tax Rate Reductions

A. The Effects of Prior Law

Prior to the 1986 Act, the Internal Revenue Code had become a bewildering array of provisions which benefited specific groups, activities or investments. For more than 20 years, the list of deductions, credits and other special rules had expanded to encourage taxpayers to undertake certain economic activities. These special provisions offered taxpayers the ability to shield income from the burden of high tax rates. The allure of these provisions was so strong that many business executives, individual investors and wage-earning taxpayers were perennially tempted to enter into transactions with limited economic merit because the tax benefits of such transactions were so attractive.

The economic inefficiencies of such tax-motivated decisions became increasingly apparent in the early 1980's. Various media issued reports of overbuilt and underutilized commercial buildings; advertisements promoted "TAX SHELTERS;" professionals who earned substantial incomes from legal tax avoidance schemes proliferated. These trends were the results of efforts to take advantage of provisions to avoid high tax rates.

The exploitation of such legitimate tax-avoidance opportunities began to take its toll in political terms. The news accounts of individual and corporate taxpayers who earned substantial incomes but paid little or no federal income tax were annoying annual reminders of the shortcomings of a system based on high rates and numerous exceptions. Although the top individual tax rate was 50 percent, it is widely believed -- and perhaps accurately so -- that not more than a relative handful of very high income individuals were actually subjected to the top marginal rate. Although large, financially profitable corporations were theoretically subject to the top corporate tax rate of 46 percent, the disparities among effective tax rates was substantial, ranging from 35 percent or higher for a few industries (including retailing in general) to 5 percent or even lower for others.

One increasingly troublesome effect of these news accounts was the lessened confidence of American taxpayers in the fairness and equity of the income tax. For a tax system based on self-assessment by citizens, this growing cynicism was a critical problem. When the tax reform process began in earnest in this Committee two years ago, one of the principal objectives was to address this potentially devastating compliance problem. The result of that process is a combination of reduced rates and a broader tax base which is producing a system under which taxpayers are much more likely to perceive that a fair share of the federal tax burden is being paid by everyone.

B. The Effective Tax Rates of Retailers

For many years, the retailing industry has been subject to significantly higher effective tax rates than many other industries because the deductions, credits and other provisions which were of use to our companies were relatively few in number. Therefore, we strongly supported the fundamental features of the tax packages proposed by the President and by this Committee. We were -- and are -- confident that the long-term benefits of an income tax system based on lower rates applied to a broader base outweigh the potential problems associated with short-term, transitional disruptions in business and personal decision-making.

Members of the Retail Tax Committee recognized that such a major overhaul of the income tax system would not have been realized without some painful and unpopular revisions to prior law. Our companies are experiencing the unpleasant results of tax reform along with other industries for which the negative impact of the 1986 Act has been widely publicized.

It is important that this Committee understand that news accounts in recent months have been incorrect in assuming that the retailing industry in general realized a tax reduction under the 1986 Act. In fact, the ten members of the Retail Tax Committee will all pay more federal income taxes for several years under the 1986 Act than under prior law. This increase in effective tax rates for our companies is the result of two changes in tax accounting methods which impact retailing very heavily -- (1) the repeal of the installment method for sales made under revolving credit plans (while other types of installment sales were not affected so harshly), and (2) the enactment of new comprehensive inventory capitalization rules. On average, it will be 1992 or 1993 before reduced tax rates will allow the cumulative income tax burden under the 1986 Act to fall to the level which our companies would have paid under prior law.

C. The Linkage of Rates and Reforms

As we contemplated the effects of these two accounting changes and other reform features of the legislation, it was explicitly understood by our members -- and, we believe, by taxpayers in general -- that tax reform legislation was developed as a package. The provisions which repealed or revised a number of deductions, credits and other rules were tied to substantial reductions in tax rates. This linkage was necessary for both substantive and political reasons.

The substantive objectives of tax reform -- to reduce the disparities in effective tax rates and to lessen the influence of tax law on economic decisions -- required both broadening the income tax base and reducing tax rates. Absent the rate reductions, the base broadening reform provisions would have imposed crippling tax burdens on the economy, and the intended benefits of tax reform would never be achieved.

Politically, it is widely acknowledged that the ability to adopt legislation in both the House and the Senate was conditioned on lessening the pain of reform with general rate reductions. Absent the rate reductions, it is likely that only a relative handful of proponents of tax reform could have been found either on Capitol Hill or anywhere else in Washington or around the country.

Proposals for delaying or limiting or otherwise diminishing the individual and corporate tax rate reductions ignore the reasons that the reductions were enacted. If any such proposal were allowed to become law, it would produce at least three undesirable results. First, it would limit the long-term benefits which were the primary goals of the 1986 Act. Second, it would break an explicit understanding with taxpayers regarding the reform package and rekindle the cynicism of recent years about federal taxation. Third, it would set in motion the inevitable efforts to reinstate old provisions and to enact new provisions to mitigate the effects of the higher rates.

II. Surtaxes As Rate Increases

Proposals for imposing surtaxes should not be considered as anything other than tax rate increases by another name and therefore should be disregarded by the Committee. Whether a surtax is imposed on income tax liability after tax credits are claimed, on income tax liability before credits are claimed, on taxable income or in some more exotic manner, the result is the same -- a higher rate of tax is imposed than under the law as now scheduled to go into effect. Therefore, a surtax is simply a less direct means for raising tax rates.

However, a surtax has one other undesirable characteristic; it does not apply uniformly to all taxpayers. Retailers have historically opposed surtaxes because the wide disparities in effective tax rates among different industries would lead to wide disparities in the impact of a surtax. For example, a 10 percent surtax applied to a taxpayer who is subject to a 35 percent effective tax rate produces the equivalent of a 3.5 percent rate increase. However, the 10 percent surtax applied to a taxpayer who is subject only to a 15 percent effective tax rate produces the equivalent of only a 1.5 percent rate increase.

The 1986 Act made significant progress in reducing the gap between high and low effective rates in the corporate community, although our Retail Tax Committee members are not going to benefit from reduced rates for many years. But the gap has not been closed. To impose a surtax would be inequitable and would reverse a portion of the progress made by the 1986 Act.

III. Limitations On Deductibility Of Advertising Expenses

The revenue options pamphlet includes proposals which would limit the deductibility of advertising costs. One of these proposals would require a taxpayer to amortize 20 percent of annual advertising costs over a four-year period. Another proposal would deny the deduction of 20 percent of corporate advertising costs and require a taxpayer to amortize the remaining 80 percent over a two-year period.

We oppose any restriction on the full deductibility of advertising costs in the year they are incurred by retailers. Proposals to limit such deductions are based on a misunderstanding of the functions served by advertising in the ordinary course of conducting a retailing business.

To a very substantial degree, our advertising is designed to apprise consumers immediately of current availability and pricing information concerning specific items or lines of merchandise. Such advertising provides consumers with the comparative information that is vital to the efficient functioning of consumer markets. Absent a steady flow of such information, consumers must either expend their time and resources looking for alternative suppliers of desired goods and competitive prices or, more likely, purchase desired goods from the first retailer they visit who has the goods on hand. Such a lack of price and product information inhibits the consumers' ability to maximize purchasing power and also discourages aggressive competition. Both of these unfortunate results also restrict an economy's ability to grow.

Furthermore, the nature of the retailing business, with profitability depending on high sales volume, requires a continuous flow of current price and product information to maintain the immediate interest of a broad range of potential customers. To suggest that advertising a line of seasonal merchandise in general -- much less a weekend price reduction on specific merchandise such as VCR units -- will produce any benefit/capital asset that has a life which extends beyond a few days or weeks is to fail to understand the purpose of such advertising altogether.

We urge that our advertising costs continue to be deductible in the year in which the costs are incurred. As a matter of tax policy, limiting the current deduction for advertising costs would be an unjustified departure from allowing "ordinary and necessary" expenses of a business to be deducted when computing the income of a retailer. Retail advertising expenditures do not produce a separate and distinct asset which benefits the taxpayer for longer than the year for which income is being computed. Therefore, such advertising costs should be fully deductible in the year the costs are incurred.

IV. Proposals Relating To Pension Plans

The revenue options pamphlet discusses several proposals which would raise revenue by changing certain requirements for private pension plans. Retail Tax Committee members, including the members of the National Retail Merchants Association and the American Retail Federation, have approximately 16,000,000 employees. A large number of these employees are covered by defined benefit pension plans and employee benefit programs and would therefore be directly affected by the proposals.

The Retail Tax Committee has addressed certain issues concerning the tax treatment of pension plans in a detailed statement which was submitted on July 1, 1987, to the staffs of the Subcommittee on Oversight of the Ways and Means Committee and of the Joint Committee on Taxation. This statement was prepared with respect to the pension funding proposal prepared by the staff of the Subcommittee on Oversight (dated June 18, 1987). The issues addressed included a proposal to increase premiums for the Pension Benefit Guarantee Corporation (PBGC) and a proposal to modify the ERISA "full funding limitation," which would effectively reduce the maximum deductible contribution an employer could make to a pension plan. Both of these proposals are presented in the revenue options pamphlet.

In general, the Retail Tax Committee supports the concept of a variable PBGC premium structure. However, we oppose the proposal to increase the "base" premium. In addition, while we support the concept of a full funding limitation, we oppose the proposal to redefine the limitation as a multiple of a plan's "termination liability."

Our positions on these matters are presented in detail in the July 1 statement and, therefore, are not restated here.

V. Proposals Relating To Employee Benefits

Under current law, an employer may provide certain necessities to employees the value of which is excludable, to some extent, from the employee's income and from wages for purposes of the FICA and FUTA taxes. As listed in the revenue options pamphlet, these "employee benefits" include the provision of: (1) health coverage; (2) group-term life insurance; (3) death benefits; (4) dependent care assistance; and (5) certain meals and lodging for the convenience of the employer. Under certain restrictions, these important benefits may be provided under flexible "cafeteria plans" which permit employees to choose various forms of benefits according to their need. The pamphlet suggests that the beneficial tax treatment accorded these employee benefit systems could be restricted or repealed in order to raise revenue.

We urge the Committee to retain the current tax law treatment of such employee benefits. The current tax treatment encourages creation of employee benefit programs to which employees otherwise might not have access, might overlook or might decide to ignore. An employer's provision to employees of health insurance, life insurance, death benefits and dependent care assistance is an effective and efficient means of assuring that a wide range of employees can afford access to systems of personal and family security which have become necessities in our society.

Another proposal that would have a significantly adverse impact on employees would impose a five percent excise tax on net investment income of all tax-exempt corporations or trusts. Great numbers of employees participate in pension and profit-sharing plans maintained by their employers. Amounts transferred to such plans provide retirement security for many employees in an era when the government retirement system -- social security -- may not be able to provide adequate retirement benefits. In order to encourage the establishment of this private retirement system, Congress has determined that income earned on amounts transferred to qualified trusts formed to facilitate the provision of employee retirement benefits would be exempt from federal income taxes.

Imposing an excise tax on net investment income earned by pension and profit-sharing plans would directly undermine the effectiveness of the private retirement system which has been carefully nurtured by Congress. In the case of defined contribution pension plans and profit-sharing plans, such a tax would reduce the amounts that are available for retiring employees, thereby placing a greater pressure on government to provide necessary retirement security. In the case of certain other pension plans (e.g., defined benefit plans), such a tax would dramatically increase the costs of maintaining such plans, thereby threatening the continued provision of benefits. We urge the Committee to protect the efficient and carefully developed private retirement system by not considering any excise tax on the income of qualified trusts established for pension and profit-sharing plans.

VI. Proposals Relating To Luxury Excise Taxes

The revenue options pamphlet contains proposals which would impose excise taxes on items such as automobiles, boats and yachts, general aviation aircraft, furs, televisions and other electronic entertainment products and jewelry. Several of the proposals include thresholds for application of the excise taxes -- e.g., an excise tax on autos would be imposed only to the extent that the value of an auto exceeds $20,000. The apparent purpose of these thresholds is to limit the impact of the tax to "wealthy" taxpayers. Thus, the pamphlet labels the proposed excise taxes "luxury excise taxes."

We oppose these taxes. As the pamphlet notes, certain excise taxes similar to those proposed were repealed by Congress under the Excise Tax Reduction Act of 1965. The reasons which led Congress to repeal such taxes in 1965 continue to apply in 1987.

For any retail excise tax to raise substantial revenue, it must apply to items which are purchased by a large consumer population, including mostly lower and middle income persons. For example, the pamphlet contains one proposal which would impose a 10 percent tax on the value of consumer electronic entertainment products (including televisions, radios, stereos, VCRs, video cameras and related products). Not surprisingly, this proposal is the only luxury excise tax proposal which would raise substantial revenue -- $7.3 billion over three years. Yet, the burden of such a tax would be borne disproportionately by the many lower to middle income customers who purchase electronic entertainment products such as televisions, radios and stereos. In addition, because these products are sold by many retailers, the costs for both retailing companies and the government of administering such a tax would be substantial.

While the other luxury excise tax proposals generally include thresholds designed to limit the regressive impact of the taxes, it is doubtful that such thresholds accomplish this objective. For example, it is unlikely that the $100 threshold proposed for a 10 percent tax on jewelry effectively limits the incidence of the tax to wealthy consumers. Even if the regressivity of these excise tax proposals could be limited, the resulting tax would not raise enough revenue to justify the costs for both businesses and the government of administering the tax, which was a principal reason for the repeal of similar excise taxes in 1965.

We urge the Committee to prevent the littering of the federal tax laws with inefficient and unfair "luxury" excise taxes.

VII. Proposals Relating To The LIFO Method Of Inventory Accounting

The revenue options pamphlet includes proposals which would repeal or penalize the use of the last-in, first-out (LIFO) method of accounting for inventories. The LIFO method assumes that items flow through a taxpayer's inventories as follows: the last goods purchased for resale are the first goods sold. In contrast, the first-in, first-out (FIFO) method assumes the opposite flow of goods for purposes of computing a taxpayer's ending inventory and cost of goods sold: the first goods purchased are the first goods sold.

We strongly urge the Committee to retain the LIFO method of inventory accounting as provided under current law. The LIFO method has long been accepted as an accurate method of reporting income for financial statement purposes. In fact, as noted in the pamphlet, the LIFO method is considered by many to be the most accurate means of measuring income during periods of inflation.

Consider a retailer who sells televisions and whose inventory of televisions grows steadily over a period of years. Under the LIFO assumption, the retailer computes ending inventory for each year by assuming that the televisions sold during any year are the televisions which were most recently purchased from the retailer's supplier. Thus, during a period of inflation, the retailer computes income by charging against gross sales revenues the costs of televisions most recently purchased from the supplier (i.e., televisions purchased at current, or near current supplier prices). If the retailer uses the FIFO assumption during a period of inflation, income would be computed by charging against gross sales revenues the costs of televisions purchased in a prior period when prices of televisions were lower than current prices. Thus, on a continuing basis, the LIFO method more clearly reflects "real" income (i.e., gross revenues at current prices less costs of goods sold at current prices), while the FIFO method reflects inflated or "nominal" income (i.e., gross revenues at current prices less costs of goods sold at prior uninflated prices).

The suggestion in the pamphlet that the LIFO method results in "tax deferral" assumes that the FIFO method is a more accurate measure of income. As the above simple example illustrates, and as many accounting specialists have stated, the assumption that FIFO is more accurate than LIFO is incorrect. In fact, it is more appropriate to view the LIFO and FIFO methods simply as conventions concerning the flow of goods through inventories. The appropriateness of this view is highlighted by the fact that, in general, if there is no inflation in prices of inventory items, then both the LIFO and FIFO conventions should produce the same ending inventory, cost of goods sold and income amounts.

Moreover, even if the LIFO method were viewed as some form of tax preference item, current tax law includes a self-enforcing mechanism against aggressive use of the method. The "LIFO conformity requirement" assures that while a LIFO taxpayer may report a lower income for tax purposes, the taxpayer must also report reduced earnings to its shareholders, partners and creditors. Thus, the LIFO conformity requirement operates to prevent aggressive use of the LIFO method for tax purposes. The self-enforcing nature of the LIFO conformity requirement is similar to the rationale behind the alternative minimum tax's "book income preference" which was enacted by the 1986 Act.

VIII. Federal Unemployment Tax Act (FUTA) Provisions

The revenue options pamphlet includes proposals which would raise revenue from the FUTA tax system. One proposal would index the FUTA wage base. Another would extend the temporary component of the gross FUTA tax rate which was specifically enacted to repay advances from general revenues to the Extended Unemployment Compensation account. These advances were provided for the sole purpose of financing extended unemployment benefits during a period of massive economic dislocation in the 1970's. This temporary rate component of 0.2 percent is scheduled to expire on January 1, 1988, because the advances were fully repaid in 1987.

We oppose changes to the FUTA tax system in the context of raising general revenues to meet reconciliation revenue targets. The FUTA tax exists for the specific purpose of financing the federal government's responsibilities with respect to the joint federal-state government unemployment insurance program. It should not be subject to the pressures of general federal budgetary demands. Of special concern is the proposal to extend the temporary 0.2 percent component of the gross FUTA tax rate. This extension would not only set an undesirable precedent of the federal government undermining the purposes of the unemployment insurance program for general revenue needs, it would also place an additional burden on payroll taxes as a source of federal revenues. Indexing the wage base would result in continuing additional increases in tax costs.

The result of increased labor costs for labor intensive employers such as retailing companies is almost always a reduction of full- and part-time jobs. Thus, there is a significant risk that the proposed extension of the temporary FUTA rate component and the proposed indexing of the wage base could have the ironic result of causing further unemployment by the very mechanism intended to alleviate the burdens of unemployment. Therefore, we urge the Committee to avoid looking to the FUTA tax system as a means of raising general revenues.

IX. General Consumption Taxes

One group of proposals which has been presented in the revenue options pamphlet is labeled "General Consumption Taxes" and includes variations of a value-added tax. We believe that consideration of such proposals is not appropriate at this time for two practical reasons.

First, the implementation of any new tax system takes time. The more complex the system, the longer the period during which its rules and regulations should be prepared and then studied by taxpayers. Any broadly-based general consumption tax system would clearly fall into this category. Development and implementation of such a new system in the context of a reconciliation bill which is intended to affect FY 1988 does not appear to be a reasonable possibility.

Second, the potential revenue to be gained from an entirely new system would far exceed the reconciliation requirements for FY 1988 and even for the three-year period FY 1988-1990. Such options would seem out of place in this context.

In addition, the consideration of a new revenue system should be undertaken in a manner which allows a full review of the many problems and economic policy concerns which such a new system would present. Like income tax reform, this would be a lengthy process and could not reasonably be undertaken in the context of reconciliation.

MEMBERS OF THE RETAIL TAX COMMITTEE OF COMMON INTEREST

Allied Stores Corporation

BATUS Retail Division

Carson Pirie Scott & Company

Carter Hawley Hale Stores, Inc.

The Dayton Hudson Corporation

Federated Department Stores, Inc.

R. H. Macy & Company, Inc.

The May Department Stores Company

J. C. Penney Company, Inc.

Sears, Roebuck and Company

American Retail Federation

National Retail Merchants Association

LCLAA
LABOR COUNCIL FOR LATIN AMERICAN ADVANCEMENT
AFL-CIO Building • Suite 707 • (202) 347-4223
815 Sixteenth Street N.W., Washington, DC 20006
La Voz del Trabajador, por Su Familia y Su País.

Statement of Jack Otero, National President
Labor Council for Latin American Advancement
Before the House Ways & Means Committee
Hearing on Revenue Increase Options
July 7, 1987

My name is Jack Otero and I am testifying on behalf of the Labor Council for Latin American Advancement (LCLAA) of which I am the National President. LCLAA is one of five AFL-CIO support groups and speaks for more than one million Hispanic workers affiliated to AFL-CIO international unions.

Among the options to raise the $19.3 billion that is needed in additional revenues to meet Fiscal Year 1988 Budget targets is an increase in the federal excise tax on products such as gasoline, beer, alcohol or cigarettes. It is our contention that an increase in these taxes puts an unfair burden on working people in this country, most particularly, Hispanics and Blacks.

At a recent meeting of the LCLAA National Executive Board, a unanimous resolution was adopted opposing any increase in excise taxes. The regressivity of excise taxes has long been an accepted fact. The major excise tax increase analyzed in a January 1987 Congressional Budget Office study would wind up costing wealthy Americans 1/10th or 1 percent of their income, while the working poor would pay an astounding 27 times as much.

The same CBO study shows that a $19 billion increase in excise taxes would eliminate the entire income tax reduction under last year's tax bill for families with annual incomes under $30,000. Even worse, it would cost the working poor, including millions of Hispanics, more than double the savings they received under the Tax Reform bill.

LCLAA is fully supportive of the AFL-CIO's position that any necessary taxation should be progressive and based on the ability to pay. Like the AFL-CIO, we took a strong stand in support of last year's tax reform effort and we oppose any efforts to undermine the benefits that middle and low income families gained from this legislation.

The 1986 Tax Reform Bill removed most of the working poor from the tax rolls and required American corporations to pay their fair share of taxes. However, we think that rates were cut too low for wealthy individuals and highly profitable corporations. We recommend that to maintain the concept of progressive taxation, the Committee should consider deferring or repealing the tax cuts which are scheduled to go into effect on January 1,1988, rather than raising taxes on low and middle income families.

We ask you to freeze the top individual tax rate at 38.5 percent, rather than reduce it to 28 percent. The 38.5% rate would apply to taxable income above $225,000 and would raise $4.7 billion in 1988 revenue.

JACK OTERO, BRAC
President

RALPH JIMENEZ, UAW
Executive Vice-President

OSCAR SANCHEZ, USWA
Secretary-Treasurer

Alfredo Montoya, USWA
Executive Director

VICE PRESIDENTS AT-LARGE
Maria Portalatin, AFT • Rudy Mendoza, CWA
S. Q. (Chano) Merino, COPE • Ricardo F. Icaza, UFCW
Damaso Seda, TWU • Linda Chavez Thompson, AFSCME

PAST PRESIDENTS
Ray Mendoza, LIUNA • Henry L. (Hank) Lacayo, UAW

"LATINO POWER THROUGH THE UNION CARD AND THE BALLOT BOX"

The current phase-out rate of 33 percent applying to taxable incomes of more than $71,900 should be made an explicit rate of 33 percent. This would apply to taxable incomes between $71,900 and $225,000 and would raise $2.8 billion in 1988 revenue.

Both of these proposals would affect those most able to pay and would leave intact the intent of the 1986 Tax Reform Act for low and middle income families.

We also suggest that the top corporate rate be cut to 38.5 percent, rather than to 34 percent as proposed. This would yield $4 billion in 1988.

Other recommendations for raising revenue which LCLAA would support include freezing of the estate and gift tax rates at the 1987 level, the imposition of a luxury tax and a surtax on upper income individuals and corporations.

Along with losing the benefits gained from the tax reform act, Hispanic workers and their families face an even greater degree of unemployment and additional economic burden if Congress agrees to increase excise taxes. They are also facing the prospect of reduced sales and loss of jobs, particularly in the industries on whose products excise taxes are levied--alcohol, brewery, tobacco, gasoline and diesel fuel.

I hope that this Committee as well as Congress as a whole will join in my opposition to the financing of government on the backs of those who are least able to pay through regressive excise taxes and instead adopt alternatives based on the concept of progressive taxation which require the wealthiest individuals and corporations to pay their fair share.

Alfred Earl Lindow, III
6115 Vinewood Dr.
Houston, Texas 77088

September 1, 1987

The Honorable Dan Rostenkowski
Committee Chairman
United States House of Representatives
Washington, D.C. 20515

Dear Mr. Rostenkowski:

As a member of the House Ways and Means Committee, you have considerable influence on the way all U.S. Citizens are taxed by our federal government. There are a number of revenue options which you are currently considering which will take "revenue" from U.S. taxpayers like myself.

Of the many revenue options being considered, I am strongly against taxation of the following:

1) Group Term Life Insurance - treatment of employer provided coverage as taxable for FICA purposes.

2) Dependent Care - phase out of income tax credit for child care expenses where AGI exceeds $50,000. (It takes two wage earners to provide a reasonable standard of living these days. Consequently, if you have children, child care expenses are a necessity, not a luxury).

3) Health Insurance - taxing employer provided health insurance coverage in any form or any amount.

4) Life Insurance - taxing the inside buildup on life insurance policies (If left untouched, life insurance cash values represent a source of retirement income).

If you want to do something positive for the budget, budget deficit, and national interest for all U.S. citizens, cut government spending to match existing government revenues. That's how I get by! Now wake-up and listen to what the majority of Americans have been saying. We've been saying it for the last eight years!

Sincerely,

Alfred Earl Lindow, III

CITY OF LONG BEACH
OFFICE OF THE CITY MANAGER
333 WEST OCEAN BOULEVARD • LONG BEACH, CALIFORNIA 90802 • (213) 590-6711

JAMES C. HANKLA
CITY MANAGER

July 13, 1987

The Honorable Dan Rostenkowski, Chairman
Committee on Ways and Means, U.S. House of Representatives
1102 Longworth House Office Building
Washington, DC 20515

Dear Chairman Rostenkowski:

The City of Long Beach appreciates the opportunity to comment on the proposals pending before your Committee relative to meeting the reconciliation instructions for raising revenues contained in the Concurrent Budget Resolution for Fiscal Year 1988. Some of these proposals would have an adverse effect upon city governments.

Among those proposals falling within the jurisdiction of your Committee which most directly impact the City of Long Beach are as follows: mandatory medicare coverage; the elimination of the deduction for personal property taxes; the imposition of the Federal gas tax on state and local governments; and further curtailment of the ability of municipalities to issue tax-exempt debt to carry out traditional functions.

Mandatory Medicare Coverage

The proposed mandatory Medicare coverage provision would cost the City of Long Beach for fiscal year 1987-88, if such a requirement were in effect, an additional $671,365.

With a working reserve for our general operations budget of less than $3.5 million, or 1.5% of the total, this would further curtail our ability to meet any unexpected needs.

Elimination or Reduction for Personal Property Tax

The personal property tax, both secured and unsecured, makes up approximately 12-1/2 % of our total property tax levies. A repeal of this deduction would, in effect, cause a direct Federal tax increase for the citizens and businesspersons of our community. Furthermore, it could impair our ability to issue general obligation bonds. The voters in California recently restored that ability, predicated on the fact that all property would be pledged to the financing of such debt upon two-thirds voter approval. This proposal casts a shadow on our ability to convince voters to approve this source of funding for necessary capital projects.

Mandatory Federal Gas Tax

This proposal repeals the local government exemption from the Federal Excise Tax for fuel that is utilized to operate fire, police, and other essential public services. In the City of Long Beach, we estimate that this proposal would cost approximately $680,000 per year. This includes our transit operation, which may very well require a fare box increase to those who can least afford it.

Advocates of this proposal have tried to justify its imposition terming it a "user fee." This is certainly not the case, because the new tax, as proposed, would not be placed in the Federal Highway Trust Fund; rather, it would be used for general purposes. Furthermore, the exemption for Federal vehicles would still be in effect. Since state and local agencies now provide the majority of funds to maintain streets and highways, we are, in essence, subsidizing Federal use of the streets. This, we feel, is revenue sharing in reverse.

Municipal Bonds

The imposition of greater restrictions and costs upon our City's ability to issue debt is unwarranted. We are still awaiting the IRS regulations as to how we must comply with the 1986 changes in tax law as they apply to municipalities.

- Increasing the individual minimum tax from 21 to 26 percent. This would increase the cost of issuing bonds for low income housing, airports, and economic development.

- Increasing the alternative corporate (book income) minimum tax. This would increase the cost of all municipal borrowing -- both for operating public services and for capital financing. Coming at a time of reduced Federal assistance and increased public infrastructure needs, this proposal is contradictory and self-defeating.

- Repealing the exemption from the individual minimum tax for general obligation and municipal revenue bonds. This suggestion would remove the tax exempt status of municipal bonds in some cases, and in reality, make such municipal bonds taxable. This frankly is another approach aimed at removing the tax exempt status of our traditional ability to incur debt for public purposes. We had hoped that this issue had been resolved by the 1986 IRC amendments.

- Reducing the State volume caps on "private activity" municipal bonds by 10 percent, across-the-board cut in individual tax preferences, and a 20 percent cut in other credits (including the low income housing tax credit, the targeted jobs tax credit and the historic rehabilitation tax credit). These actions would further restrict the capacity of local government to protect and encourage investment in low income housing, employment training, and physical and economic development. It would make "privatization" even more difficult and reduce private and public cooperation so essential to rebuilding our cities.

In closing, the City of Long Beach has, like Congress, faced a very difficult period in the development of our 1987-88 Annual Budget. Our preliminary budget had a $38 million shortfall for the financing of traditional City services. We were able through a combination of reduced service levels and increases in local taxes to balance the budget and to provide for essential fire, police and other services. City governments cannot afford any additional expenses imposed by the Federal government or loss of revenue-raising tools.

Again, thank you for this opportunity to comment on these proposals.

Sincerely,

James C Hankla

James C. Hankla
City Manager

JCH/mtm

COMMENTS BY

RICHARD B. DIXON

CHIEF ADMINISTRATIVE OFFICER

COUNTY OF LOS ANGELES

The possible options to increase revenues now being considered by the Committee on Ways and Means in the House of Representatives represent difficult choices to be made in what is an extremely difficult decade for government financing. It takes political courage even to suggest revenue increases to help cure the federal deficit problem. However, in considering options to raise additional revenues, the Committee must be mindful of the consequences to state and local governments.

We in state and local government have a historic partnership with the federal government in financing and providing a multitude of services. Revenue-raising options which impose indirect and direct taxes on us jeopardize this partnership and, more importantly, the provision of these services.

The County of Los Angeles faces severe budget cutbacks because of our open-ended, caseload-driven services (often mandated by the federal and state governments) coupled with an inadequate financing base, including the recent loss of General Revenue Sharing. These constraints are explained in greater detail further on in these comments. Several of the revenue-raising options under consideration would exacerbate our budget problems. They also would violate a long-standing principle of intergovernmental fiscal comity.

Comments on Tax-Raising Options

We would like to present the following comments on the revenue-raising options which will have an adverse effect on Los Angeles County.

1. Mandatory Medicare Coverage for All Public Employees

   Under current law all public employees hired after March 1, 1986 are covered by Medicare. The current Medicare cost for Los Angeles County is $2.2 million (with an equal amount paid by covered employees). Medicare coverage for all current County employees would cost us an additional $27.3 million per year (with the same cost increase borne by our employees).

   This proposal is contrary to the compromise agreed upon by Congress last year to phase in Medicare through new hires. It would result in immediate budget cuts for the County because we have no alternative means of financing an expenditure of this magnitude.

2. Tax Exempt Bond Interest as a Preference Item in the Alternative Minimum Tax

   The Tax Reform Act of 1986 made interest on certain "private activity" municipal bonds subject to the alternative minimum tax. This has increased the County's cost of short-term borrowing for "private activity" purposes by about 35 basis points. The County expects to borrow approximately $785 million in the short-term market this year. If all tax exempt interest were to be treated as a preference item in the alternative minimum tax, the County's cost of short-term borrowing alone would increase by $2.7 million per year.

   Simply put, this proposal will increase our interest costs in borrowing for legitimate government purposes for what will probably result in a negligible increase in federal tax revenues. This proposal is another tax on state and local government which is in violation of intergovernmental fiscal comity.

3. Repeal of Highway Excise Tax Exemption for State and Local Governments

This proposal would increase Los Angeles County's costs by approximately $1 million per year (assuming no increase in the excise tax rate). This will have an immediate and direct adverse impact on our ability to finance services. Most of our County fleet consists of law enforcement vehicles, fire engines, and other specialized vehicles which provide important governmental services. We fail to see why these essential governmental functions should be taxed by the federal government. This proposal represents a direct and inequitable tax on state and local governments.

4. Employee Benefits

Several of the options will increase the tax liability of the employee benefit components paid by the County of Los Angeles. The specific options involve limiting the exclusion from taxation of employer-provided health coverage, group life insurance, flexible benefit plans, and dependent care reimbursement accounts. Our concern is twofold: 1) the recruitment and retention of skilled employees; and 2) the future cost of these benefits to maintain the employees' current compensation package.

In response to cost shifts and limited available financing, Los Angeles County has reduced the cost of our employee compensation packages and increased employees' take-home pay by utilizing federal tax law. We do not have the financial capability to deliver equivalent compensation packages under these proposed tax law changes. Further limitations on the design of our compensation packages would result either in service reductions (because of cost increases) or in a reduced capacity to recruit and retain employees because of inadequate total compensation. An example of the latter is the value of having a cadre of highly qualified District Attorney prosecution staff who can take on major felony cases, such as drug dealing, where the dollars available for the defense are virtually unlimited. Over the past decade we have been able to retain this experienced group of attorneys due in large part to our overall compensation package. A change in federal tax law regarding the taxability of employee benefits could result in a substantial reduction in services, including the loss of these attorneys.

5. Disallowance of Deduction for Nonbusiness Personal Property Taxes

Personal property taxes are an important local revenue source for counties in California. In the past, Los Angeles County has supported state legislation to revise vehicle depreciation schedules to increase the personal property taxes associated with this tax base. We believe that further depreciation revisions can be justified based upon market values of used vehicles. A change in federal tax policy to disallow deductions for personal property taxes would disrupt such efforts and, in effect, would impose federal control over a local tax base. Federal vehicles, of course, are exempted from this tax base.

Background on Los Angeles County

We would like to provide you with some specific information on Los Angeles County so that the above comments can be put into perspective. First, we would like to briefly review where counties fit into the intergovernmental scheme in California.

In California, counties are a multiservice form of government. The 58 counties in California are responsible for a wide range of local, regional, and human services. For example, counties in California are the local agencies responsible under State law for providing health, welfare, justice, and other key regional services to all the residents of the county. Counties also provide municipal services to unincorporated areas. In Los Angeles County, this includes over one million people in rural, wilderness, suburban, and urban areas of the County. Our County also provides a wide range of municipal services, including police, fire, and library services, to many of the 84 cities in the County.

In Los Angeles County, all of these functions are performed on a giant scale. Los Angeles County has a total population of eight million residents, which is about 31 percent of California's population, spread over more than 4,000 square miles. We are the most populous County in the nation -- in fact, our population is larger than 42 of the 50 States.

Here are just some of the programs that Los Angeles County operates:

- seven hospitals, 45 health centers, three comprehensive health centers, and two alcoholic rehabilitation centers;
- the largest system of local jail facilities in the United States, with currently about 23,000 inmates;
- twenty-four municipal courts, 21 superior court locations, and one justice court. Our superior court is the largest court of original jurisdiction in the United States, and our District Attorney is the largest prosecutorial agency, with over 2,000 employees.

We also conduct elections and operate libraries, small craft harbors, the Los Angeles Music Center, the Hollywood Bowl, almost 100 parks, ten beaches, two museums, and three botanical gardens.

In other words, County government has a major impact on the health, safety, and well-being of everyone in the County.

By many measures, the Los Angeles area is in good economic shape in comparison with other areas in the nation. Many of the nation's leading manufacturing and financial institutions are centered in Los Angeles, and there is an increasing flow of international investment and trade.

But there is also a downside to the Los Angeles economic picture. With 30.7 percent of the State's population, the County also has:

- thirty-eight percent of the State's Aid to Families with Dependent Children (AFDC) population (620,000 recipients);

- -- fifty-two percent of the State's General Relief Population (over 40,000 recipients);
- -- forty-five percent of the State's violent crime;
- -- forty-six percent of the State's drug arrests;
- -- forty percent of the State's felony arrests;
- -- the largest homeless population in the country; and
- -- according to the 1980 census, our County has 32 percent of the illegal aliens in the nation.

We are in serious and chronic fiscal trouble in Los Angeles County. The basic problem is that County government does not benefit from the upside of the economy -- the increased sales and income tax revenue derived from economic prosperity -- but County government is mandated to pay for the downside -- the indigent health, human services, general relief, jails, and justice system costs. These programs are caseload-driven, rapidly growing, and must be funded.

The open-ended costs include:

- -- health care and general relief to the indigent;
- -- Aid to Families with Dependent Children;
- -- courts and related programs such as prosecution and indigent defense; and,
- -- jails and juvenile detention.

In Los Angeles County, the costs for responding to these needs now consume 56 percent of our County's so-called discretionary revenues -- such as property and sales tax revenues. Only 44 percent of our discretionary revenues are available today to fund critical local programs, such as:

- -- the Sheriff's Department;
- -- fire protection; and,
- -- recreation, culture, and other government services.

Moreover, health, welfare, and justice costs are growing at a faster rate than the revenues available to the County to pay for them. In Los Angeles County, local costs for welfare have increased by 158 percent since 1980. Health and mental health costs have increased by 83 percent. Jail and detention costs have increased by 157 percent. However, the local revenues available to fund these mandates have increased by only 78 percent.

Why doesn't the County's revenue keep up with its costs? There are three reasons.

The first reason is that the County's principal revenue source, the property tax, is limited by the State constitution in both its base and growth, and has been eroded by Community Redevelopment Agencies which now siphon off $100 million per year in property taxes from the County General Fund and special districts. The second reason is that other major revenue sources, such as the sales tax, are only minimally available in

Los Angeles County because most areas in the County that generate sales tax are incorporated or are quickly annexed. Among California counties, Los Angeles County has the second lowest per capita sales tax revenue in the State. The third reason is that counties have no independent revenue source. Unlike cities, counties cannot impose taxes or charges in excess of costs. Essentially, counties have a fixed revenue base and must trim property-related services to fit whatever revenue is left after State-mandated services have been provided.

In January 1987, we projected a potential $170 million deficit in our 1987-88 budget. (Continuation of General Revenue Sharing would have eliminated almost one-half of this deficit.) Because the County is required by State law to have a balanced budget, this potential deficit had to be eliminated. We were able to erase some of the potential deficit through productivity savings, contracting out of services, fee increases, and other initiatives, but it was still necessary to cut programs by $73.7 million to live within our resources.

These proposed curtailments, which are now under final consideration by our Board of Supervisors, include:

-- closure of seven public health centers;

-- elimination of ambulatory care clinic programs in eight health centers;

-- deletion of all specialty and adult dental services in health centers;

-- elimination of seven heroin detoxification locations;

-- closure of two substance abuse residential rehabilitation centers;

-- reduction in hospital outpatient and inpatient services in five hospitals;

-- across-the-board curtailment of over 1,000 employee positions in our Welfare Department, resulting in a substantial increase in eligibility worker caseloads in Aid to Families with Dependent Children and other programs, which may result in increased fraud and program errors;

-- curtailment in mental health outreach and outpatient services, and elimination of 156 employee positions; and,

-- the elimination of specialized and preventive programs in our Probation Department, including school crime suppression, child abuse cases, narcotics testing, community youth sports and arts, and school-based gang prevention programs.

Conclusion

Certain problems are beyond the capacity of local government to solve. International unrest and third world conditions can result in a County government being inundated with needy refugees and immigrants who need health, welfare and housing. National and global economic factors can result in the elimination of a local area's economic base, leaving its residents both in need of services and unable to contribute to the tax base. In urbanized counties such as Los Angeles, there has been an influx of the homeless and the mentally ill from throughout the country, which has placed special strains on our limited resources. These kinds of problems are national in character and beyond the fiscal scope of local communities.

We firmly believe that the fiscal integrity of state and local governments must be respected in whatever final mix of revenue-raising options you adopt. We cannot continue to provide services absent both direct federal subventions and a federal tax policy which is neutral towards our current finances.

Thank you for this opportunity to provide comments.

888 Worcester Street, P.O. Box 66, Wellesley Hills, Mass. 02181 · (617) 237-3030 MEDTAC

July 23, 1987

Honorable Dan Rostenkowski
Chairman, Ways & Means Committee
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

MED-TAC Corporation is a Third Party Administration organization that administers the self-funded employee health plans of companies on behalf of their employees. Our portfolio of employer clients include many small to medium sized companies, as well as larger firms. These clients are, for the most part, located in New England, but many have branches nationwide.

As Chairman of the House Ways & Means Committee and the Joint Committee on Taxation, you are presently considering revenue-raising options with the goal of raising approximately $65 billion over the next three years. I want to take this opportunity to pass on some comments regarding this effort.

We here at MED-TAC Corporation and our colleagues in Third Party Administration that make up the Society of Professional Benefit Administrators (SPBA) realize only too well the extent of the health care problems facing this nation, as well as the imperative need to balance the Federal Budget. While we applaud the Committee's effort to explore additional sources of revenue, we are concerned about the effects of such laudable efforts on the employee benefit system. Before proceeding, I would like to state we are very willing to consult with any member of Congress, or their staff, to assist in this effort. Our goal is to move toward workable and fair solutions.

As I understand it, the principle of tax-exemptions or credits is to encourage the entity having such exemptions or credits to exist and to continue the valuable efforts the entity was designed to promote. Chairitable organizations, universities, church organizations, YMCA/YWCAs, etc., foundations, etc., fall into this category. Also included, for much the same reasons, are employee benefit funds established to provide a valuable and, in some cases, lifesaving benefit.

Small and medium sized businesses are the focus of current legislative efforts to provide mandated benefits to their employees. It is perceived by Congress the majority of the 37 million "uninsureds" in this country are employees and dependents of small businesses. It is also a fact (according to a recent SBA study) that more then 75% of small and medium-sized businesses currently provide such coverage. One of the primary factors enabling these businesses to provide such protection is the tax exemptions these employee benefit funds have. Additionally, if small and medium-sized businesses not currently able to provide health coverage are to be mandated to do so, the full tax exemption needed to fund such coverage should be available.

Thus, we are concerned about the effect of proposed taxation of employee benefit strategies to be included in the Budget bills. It seems contradictory to, on the one hand, require small businesses to provide coverage while, at the same time, reducing or removing the major financial incentives to do so.

Among the various revenue-raising options we understand are being considered by the Joint Taxation and Ways and Means Committees are:

1. A repeal of the exclusion for employer group term life insurance or a repeal of the exclusion for FICA and FUTA taxes on group term life insurance only. Providing such insurance protection is an important and valuable component of any employer's compensation to his employees. We feel such a restriction would discourage such plans as well as add to the tax burden of the individual taxpayer by raising the income subject to taxation.

2. A proposal to tax employer-provided health plans above a specified limit of $840 for individuals and $2,100 for families. Again, this would add a disincentive to both employers and employees for such coverage by increasing their respective tax burdens.

3. To eliminate the exclusion for "flexible or cafeteria" plan benefits with, including a cap on the cash option of $500 per year. The major reason some employers have adopted such plans is to provide benefits related to the changing demographics of the workforce and to allow employees to plan the type of benefits that best suit their particular situation. Additionally, these plans have proven to be positive forces toward containing the raising cost of health care in the US. Why erect tax barriers that would slow or cripple development of these innovative plans?

Two final points:

First, serious consideration should be given to the idea of a National Sales Tax or a Value-Added Tax. We understand potential revenue estimates run as high as $150 billion per year. Combined with some wise budgeting, this additional revenue would almost assure the US could meet the Gramm-Rudman goals. It is a more fair tax, asking each of us to help reduce the deficit, not just certain segments of society. Alternatively, how about a National Lottery, the proceeds of which would be earmarked for deficit reduction only?

Secondly, if the Committee's desire to raise revenue is greater than its desire to protect tax-exemptions and the good purposes they support, we suggest an element of fairness in the selection process to remove or limit such exemptions. The businesses and individuals whose employee benefits the Committee intends to tax already pay billions of dollars in taxes of one kind or another. However, the tax-exempt institutions, such as church organizations, YMCA/YWCAs, educational institutions, charities and various foundations pay little or no taxes. The original intent was the "good works" these organizations provide would outweigh the taxes they could pay -- the same principle applies to employee benefit plans. These institutions should be taxed as well, as they enjoy the advantages and protection of the Federal Government as well as businesses, but don't pay for it like businesses do.

We hope you will accept these comments and recommendations that are sincerely extended in the spirit of cooperation and support. We believe the deficit problem can be solved. We again pledge our willingness to work with the Congress and with members of your committee to meet this challenge.

Sincerely,

Lee Grimes
Marketing Director

Frederick S. Hammer

Meritor Financial Group

Meritor

July 30, 1987

The Honorable Daniel Rostenkowski
2111 Rayburn House Office Building
South Capitol Street & Independence Avenue, S.E.
Washington, D.C. 20515

Dear Congressman Rostenkowski:

I am writing to voice the concern of Meritor Financial Group regarding recent "discussion options" published by the Ways and Means Committee, which outline potential actions to increase tax revenues. Meritor Financial Group is a $20.2 billion financial institution, with nationwide residential mortgage and commercial loan capability and with depository institutions in Philadelphia, Florida, and in the Washington, D. C., SMSA.

We have two general concerns. The first matter involves the option to limit or remove inter-corporate dividends received deduction. Currently, we have subsidiaries that hold over $650 million in securities related to residential mortgages and that issue preferred stock. The removal of the deduction would have a significantly adverse impact on the market for such preferred stock and, therefore, a similar adverse impact on our capability to finance profitably our holdings of a substantial volume of residential mortgages. While not a spokesman for the thrift industry, many other lenders would be similarly impacted. Especially in an economic climate in which banks and thrifts are urged to raise capital, the subject option carries a message antithetical to the expressed views of banking regulators. (Incidentally, while overlooked by some, the option being discussed by Ways and Means to deny use of preferreds to absorb loss-carryforwards would have the same deleterious economic effect.)

My second concern relates to the option to end or limit the ability of customers to deduct interest paid on second mortgages. Significant confusion would arise from a change at this time. Taxpayers have undertaken some time and expense of applying for a second mortgage and would be faced with unfair consequences if the law would be changed suddenly. As to impact on Meritor, nationwide we employ over 250 people, and have outstanding over one half a billion dollars, in second mortgages alone, and we anticipate that unstudied action will negatively effect employment levels and our profitability.

The revenue impact of a change in law is not predictable, in view of the fact that usage patterns are not very well developed on these types of lines of credit and, according to a recent Federal Reserve survey, only six or seven percent of households carry these loans. Should changes in the law be imminent, it is impossible to correctly project the borrowing behavior of consumers, and so the forecast of potential "revenue gain" in the proposal should be taken with a grain of salt.

We suggest that Congress delay action on a proposal to tax second mortgages until there has been time to study the issue. The Consumer Bankers Association, for example, will soon complete its research on usage patterns of home equity loans. The time necessary to study the issues is not that significant -- these surveys should be completed in 1988 -- and, at that time, it would appear that Congress could act with all relevant information available.

With these points in mind, I urge you to carefully review any proposals for change. Thank you for your attention to this matter.

Sincerely,

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NACSA
NATIONAL ASSOCIATION of
CASUALTY & SURETY AGENTS
Government Affairs Office
Joan Albert Dreux
Executive Director

July 20, 1987

The Honorable Dan Rostenkowski
Chairman, House Ways and Means Committee
U. S. House of Representatives
Washington, D.C. 20515

Re: Joint Committee on Taxation's Proposed Options to Raise Revenues for the 1988 Budget Reconciliation Bill

Dear Chairman Rostenkowski:

On behalf of the National Association of Casualty & Surety Agents (NACSA), an association representing some three hundred of the nation's leading commercial insurance agencies and brokerage firms specializing in employee benefits, property/casualty, and life insurance, I would like to submit for the record of the House Ways and Means Committee NACSA's opposition to the Joint Committee on Taxation's proposed revenue options which would alter the tax treatment of employee benefits and individual life insurance and annuity products.

Over the past six years or so, the tax treatment of these various insurance products, employer-provided and otherwise, have been extensively analyzed and thoroughly debated in Congress. Policy decisions on their tax treatment have been made as recently as December 1986. To reverse at this time these public policies, all of which were a part of a delicately derived revenue package, would be unfair and unsound economic policy. The potential impact on the financial security of the majority of working Americans, let alone others, would be severe and far reaching.

In particular, NACSA opposes:

1) Taxing employer-provided group health benefits,

2) Taxing employer-provided group life insurance coverage valued at $50,000 or less,

3) Taxing the inside build up of individual life insurance and annuity policies, and

4) Including as part of a decedent's estate the proceeds from a life insurance policy which had been assigned to a relative of the decedent.

Casualty/Surety/Fire/Marine
Founded in 1913

600 Pennsylvania Avenue, S.E.
Suite 211
Washington, D.C. 20003
(202) 547-6616

Current tax policy for employer-provided health and life benefits encourages employers to provide an important financial safety net for the majority of workers and encourages employees to retain adequate health and financial protection. If these benefits were taxed, employees, as well as employers, might choose to reduce or eliminate these important benefits. Additionally, removing these tax incentives goes against current trends which encourage employers to expand their benefit packages.

As to the inside build up, for one thing, it is unfair to tax as income value that has not yet been realized by a policy holder.

And, finally, as to including the death benefits of a life insurance policy in the estate of an individual who had assigned the benefits directly or indirectly to a relative, current gift tax policies already draw revenue from this type of transfer.

NACSA hopes you will take these views under serious consideration when reviewing these revenue raising proposals.

Sincerely,

Joan Albert Dreux

Joan Albert Dreux
Executive Director
Government Affairs

JAD/mbm
cc: Members of the House Ways and Means Committee

STATEMENT OF
The NATIONAL ASSOCIATION OF HOME BUILDERS
before the
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
on
REVENUE INCREASE OPTIONS
JULY 15, 1987

The National Association of Home Builders (NAHB), a trade association representing more than 147,000 members, is pleased to have this opportunity to submit a statement for the hearing before the House Committee on Ways and Means on revenue increase options.

The 99th Congress spent a substantial amount of time and effort in enacting a tax reform bill that many people did not want and that many more people do not understand. NAHB was vocal in its opposition to the tax reform effort, beginning with the release of the Treasury's first set of proposals in November of 1984, and continuing through October 22, 1986, the day President Reagan signed the bill. The housing and real estate industry has paid its dues both in budget cuts since 1980 and through tax reform. Revenue options should now be directed elsewhere.

NAHB continues to be concerned about certain aspects of the Tax Reform Act of 1986. The jury is still out on the Tax Reform Act of 1986. Certainly, there are some positive aspects in the 1986 Tax Act, such as substantial tax rate reduction for individuals and corporations and the removal of several million taxpayers from the tax rolls. However, we feel that the negative aspects may still outweigh the positive aspects. Many of the negative aspects of tax reform will not even be known to a substantial number of taxpayers until next year when they begin filing their 1987 tax returns.

Like many sectors of the economy, housing won some battles and lost some battles in the quest for tax reform. With regard to single-family housing, NAHB was pleased, of course, that the law retained deductions for mortgage interest on up to two residences of a taxpayer and deductions for real property taxes. We were encouraged by the retention of the mortgage revenue bond program, even though it was cut back significantly in terms of volume. However, NAHB was quite discouraged with the large number of adverse changes affecting multifamily housing. These changes included repeal of the long-term capital gains exclusion, substantial lengthening of real property depreciable lives, imposition of the passive activity loss limitation, and a significantly more inclusive minimum tax.

Current NAHB policy strongly endorses the use of tax incentives to promote home ownership and construction and rehabilitation of affordable rental housing. Because tax incentives for rental housing have been eliminated or sharply curtailed and tax-exempt financing for housing has been restricted under the new tax law, NAHB believes there will be higher rents and less low-and moderate-income housing available. We will monitor the impacts of tax reform on various segments of the housing market and, when necessary, suggest corrective legislation. While it is too early to know the full impact of tax reform on multifamily housing, it is already clear that multifamily housing has been affected adversely. Multifamily housing starts during April, 1987, fell to an annual rate of 449,000, down 14 percent from March. For the first four months of 1987, multifamily construction was off 28 percent from the building rate of a year ago. Multifamily starts in May increased by 10.8 percent, to an annual rate of 491,000 units. However, an ongoing decline in multifamily building permits, which dropped to a rate of 472,000 in May, suggests that multifamily housing starts will drop further this year as the result of high vacancy rates and the new tax law.

NAHB surveyed its members on the impact of tax reform at its 1987 Annual Convention and Exposition in January. 92 percent of our multifamily builders felt tax reform would be negative. Specifically, the effect of tax reform on multifamily for sale and multifamily for rent will be "very negative" to "somewhat negative" according to 40 percent and 52 percent of builders, respectively. In contrast, about 20 percent of builders felt that the effect of tax reform on single-family housing will be "somewhat negative" to "very negative."

In its testimony before the Ways and Means Committee in 1985, NAHB stated that tax reform should facilitate tax compliance with an eye towards fairness and deficit reduction. Tax reform largely has failed on both grounds. There was no deficit reduction, because the increased revenues achieved from base broadening was used to reduce the tax rates rather than being applied to deficit reduction. Had some of the revenues generated from base broadening been applied to deficit reduction, our members might have understood the need for sacrifice. Having contributed substantially to the rate reductions in the 1986 Tax Act, we oppose efforts that would delay or postpone the implementation of these rate reductions. Tax reform also failed on the count of fairness because of the disproportionate burden that was borne by the real estate industry. One needs only to examine the passive activity loss rules and the way they deem rental real estate (and no other activity) to be a passive activity, without regard to material participation, to see how unfair the 1986 Tax Act is. The passive activity loss rules, alone, amount to a tax increase of $36 billion over the next five years, a large part of which will be borne by the real estate industry.

Because the housing sector of the economy bore such a large share of the base-broadening changes that funded last year's tax reduction, NAHB submits that it would be inequitable to again single out housing to bear the burden of deficit reduction. Housing also has paid a disproportionate share in budget cuts, where over 70 percent of budget cuts have been made in housing since 1980. NAHB believes that the deficit should be reduced through an appropriate mix of fiscal and monetary policies. If the tax system is going to be revised in order to reduce the deficit, the revision should be done in such a way to spread the pain among all individuals and businesses. Furthermore, the Committee should remain cognizant of the significant tax increases that were imposed upon the real estate industry both by the Tax Reform Act of 1986 and the Deficit Reduction Act of 1984.

The "Description of Possible Options to Increase Revenues" (JCS-17-87), prepared for the Committee on Ways and Means by the staff of the Joint Committee on Taxation with the staff of the Committee on Ways and Means, contains several revenue increase options that concern NAHB because of their potential adverse impacts upon home owners and the housing industry.

Among the options that would affect home owners are:

o Across-the-board reductions in the benefit of itemized deductions;

On the one hand, we understand why Congress restricted the mortgage interest deduction in this manner. The concern was that homeowners could largely avoid the new limits on deductibility of interest on personal loans merely by using their homes as collateral for consumer debt. On the other hand, it should be noted that for many Americans their homes represent the bulk of their accumulated wealth. We do not believe that homeowners should be forced to sell their homes in order to make use of that wealth. Thus, while there may have been some rationale to the restrictions imposed by the 1986 Tax Act, we urge that no further changes be made in this area.

We oppose other revenue options that would cut back on the benefit of the mortgage interest deduction. These include an across-the-board reduction of 10 percent for itemized deductions, the imposition of a floor under the aggregate itemized deductions of higher-income taxpayers, and limiting the benefit of itemized deductions to the lowest tax rate. Each of these proposals would diminish the tax incentives for home ownership and, thus, would make homeownership less affordable. Furthermore, each of the proposals would make an already complex tax system even more complicated, and, thus, could foster wide-spread disrespect for the tax system among middle-and higher-income taxpayers.

Finally, we oppose the income taxation of the net appreciation in property passing at death because of the increased record keeping burdens that would be imposed, the tax compliance problems that would be caused, and the increase in taxes on assets passing from one generation to another.

Revenue Options Affecting The Housing Industry

There is no question that home builders were adversely impacted by the Tax Reform Act of 1986. Single-family home builders were hurt by the taxation of contributions in aid of construction (which has added significantly to the cost of construction), the proportionate disallowance rule applicable to installment sales, and the new volume limitation on mortgage revenue bonds. The taxation of contributions in aid of construction, which many Members of Congress understood merely to be a tax increase for utility companies, has been a tremendous burden for many single-family home builders. This is because the utility companies basically have been "grossing-up" the tax cost to builders. Assuming a 40-percent Federal corporate tax rate, this gross-up to the builder amounts to a 67 percent increase in the cost of utility infrastructure.

Multifamily home builders were adversely affected by, among other provisions, the repeal of the capital gains exclusion, the substantial lengthening of depreciation lives, the passive activity loss restrictions, the volume limits on multifamily industrial development bonds, and the broader minimum tax. Since home builders, in effect, paid for a large part of last year's tax rate reductions, NAHB does not think that it would be equitable to now ask that home builders bear the burden of deficit reduction.

The benefit of the installment sales method of accounting was reduced significantly both for dealers and nondealers by the imposition of the incredibly complex proportionate disallowance rule. Furthermore, for home builders who are subject to the minimum tax, the installment sale method was repealed. NAHB supports H.R. 567, which would restore prior law for non-dealer installment sales. With regard to dealer installment sales, rather than repealing the installment sale method entirely, NAHB would urge you to look at a simpler alternative to the proportionate disallowance rule. One possibility might be to impose a flat-percentage disallowance on deferral of profits from dealer installment sales. For example, one-third of the profit could be included in income in the year of sale, thereby allowing

- Repealing, or otherwise restricting, interest deductions on home equity loans;
- Limiting the benefit of itemized deductions to the lowest tax rate bracket;
- Disallowance of deductions for nonbusiness personal property taxes;
- Imposition of a floor under aggregate itemized deductions of higher-income taxpayers; and
- Income taxation of net appreciation in property passing at death.

Among the options that would affect the housing industry are:

- Imposition of a value added tax or a business alternative minimum tax;
- Reduction in corporate tax preferences;
- Repeal of the completed contract method of accounting for large contractors;
- Limitations on deductibility of advertising costs;
- Repeal of the installment sales method for dealers and certain nondealers;
- Taxation of master limited partnerships as corporations;
- Several proposed changes regarding limited partnerships, including treatment of limited partnership income as portfolio (rather than passive) income under the passive activity loss rules;
- Repeal of like-kind exchange treatment for real estate;
- Increases in individual and corporate minimum tax rates; and
- Withholding on payments to independent contractors.

Revenue Options Affecting Home Owners

The Internal Revenue Code historically has provided several tax incentives to encourage homeownership. The major tax incentive for homeownership is the mortgage interest deduction. Without the mortgage interest deduction, the cost of home ownership would be significantly higher.

For the first time in 40 years, the homeownership rate in the United States is declining. This trend, which started in 1980, is most pronounced among young Americans considering the purchase of their first home. The homeownership rate among all households peaked in 1980 at 65.6 percent. Since then, it has fallen to 63.8 percent. Among married couples in the 25 to 29 age group, homeownership fell from a rate of 59 percent in 1978 to 52 percent in the first quarter of 1987. For married couples in the 30 to 34 age group, the homeownership rate fell from 75 percent in 1978 to 70 percent in 1985. Given this downward trend in the homeownership rate, NAHB urges that the Tax Code not be tampered with in such a way to make homeownership less affordable. In fact, in a different budgetary climate, we would be urging new tax incentives designed to make homeownership more affordable, particularly for young American families. For example, for years, we have supported the concept of providing a housing savings account, similar to an individual retirement account, to assist first-time home buyers in accumulating a downpayment.

While the Tax Reform Act of 1986 largely preserved the tax deduction for mortgage interest, it did cut back on the mortgage interest deduction in two significant ways. First, the deduction for mortgage interest was limited to debt on no more than two personal residences of a taxpayer. Second, the amount of debt against which mortgage interest deductions may be taken generally was limited to the purchase price of the home plus the cost of improvements. However, an exception was provided for qualified educational loans and loans for medical expenses, to the extent that the debt is secured by a personal residence and does not exceed its fair market value.

deferral of only two-thirds of profit. This would be far simpler than the proportionate disallowance rule of present law, and would be much more fair than repeal of the installment method because it would recognize the liquidity problem inherent in installment sales.

Another accounting proposal that concerns NAHB is the proposed repeal of the completed contract method of accounting. Under the percentage of completion-capitalized cost method that was implemented by the 1986 Tax Act, large contractors must take into account 40 percent of the items with respect to a contract under the percentage of completion method. The remaining 60 percent of the items under the contract must be taken into account under the taxpayer's normal method of accounting (for example, the completed contract method). NAHB opposes implementation of the percentage of completion method for long-term contracts because builders who engage in the performance of long-term contracts are not certain of the amount, if any, of the profit they will realize on the contract; builders earn profits on long-term contracts only at the time they are completed (rather than on a proportionate basis over the term of the contract); and, in the absence of substantial progress payments in excess of out-of-pocket expenses, builders may not have sufficient funds to pay tax prior to the completion of the contract.

NAHB opposes repeal of like-kind exchange treatment for real estate because like-kind exchanges merely involve a change in the form of investment and, thus, should not immediately give rise to tax liability. Furthermore, the present law provision which allows nonrecognition of gain on like-kind exchanges of real estate facilitates the mobility of capital. Limiting like-kind exchange treatment to simultaneous transfers of real estate would impose serious hardships on transferors who cannot immediately locate suitable replacement property. Moreover, it should be noted that the Deficit Reduction Act of 1984 already has limited the flexibility of like-kind exchange treatment generally by providing that transactions can qualify for nonrecognition treatment only if replacement property is identified within 45 days and transferred within 180 days of the original transfer.

Several of the revenue increase options presented for the Committee's consideration deal with limited partnerships, including master limited partnerships. Notwithstanding the adverse tax changes contained in the Tax Reform Act of 1986, limited partnerships remain a popular investment tool because they allow individuals to invest in more and larger projects than they could individually. The average investor has neither the time nor expertise required to identify desirable projects; conduct feasibility studies; or arrange for acquisition, financing, construction, or rehabilitation or ultimate management of the project. With a limited partnership syndication, these tasks are entrusted to professionals.

Master limited partnerships (MLPs) are a comparatively new form of ownership for real estate, especially for existing properties. MLPs are limited partnerships in which the partnership interests are traded on a national stock exchange. Investor interest in MLPs is high because, in contrast to most limited partnerships and other real estate investments, the ownership shares are liquid, thus allowing investors who need cash to easily sell their shares. Despite this liquidity, investors are able to avoid the double taxation inherent to corporations.

Limited partnerships are a valuable financing tool for raising the capital needed to construct new housing. Because the 1986 Tax Act severely limited the tax advantages from limited partnership investments in real estate, investors are now forced to consider the economics of an investment, largely without regard to any tax benefits. Due to this fact, we urge you not to adopt further changes that would have an adverse effect on limited partnerships, and, thus impede the flow of money needed for new construction.

We are particularly concerned with the proposals that would tax MLPs as corporations and treat net income of a limited partnership as portfolio (rather than passive) income. With regard to MLPs, there is little evidence that real estate MLPs are causing an erosion of the corporate income tax base. For example, limited partnerships have been traditionally used for holding real property. Using the MLP format to improve liquidity is a valuable tool for attracting investment capital.

To arbitrarily deem net limited partnership income to be portfolio income, while net limited partnership losses are treated as passive losses, would basically negate the viability of the limited partnership form as a tool for real estate investment. It would mean that losses could not be deducted against income generated from another partnership. This would be almost tantamount to disallowing limited partnerships as a tool for real estate investment. To further restrict the viability of limited partnerships, before the ink has even dried on the Tax Reform Act of 1986, would be patently unfair.

Several other proposed revenue increase options concern NAHB because they would mean increased taxes for home builders, which, ultimately, would mean increased prices for new homes. These options include limitation on the deductibility of advertising costs, increases in corporate and minimum tax rates, and withholding on payments to independent contractors.

Taxes for many builders will increase substantially this year due to last year's tax reform. NAHB feels it would be unfair to again raise the taxes of these builders before the full impacts of the 1986 Tax Act are even fully felt. Furthermore, we question the utility of requiring withholding on payments to independent contractors when those payments are already required to be reported to the Internal Revenue Service. Rather than increasing tax compliance, requiring withholding on payments to independent contractors would only add complexity and additional administrative costs and burdens for builders who use independent contractors in their construction business.

One bright point in the revenue options deals with the reinstitution of a capital gains tax differential. NAHB, of course, would support favorable tax treatment for capital gains, but not at the expense of other options that would increase taxes for home owners and home builders. A reduced capital gains tax rate would likely increase Federal tax revenues because it would promote economic growth.

Finally, we would like to note the discussion of a value added tax (VAT) and a business alternative minimum tax (BAMT). These are ideas that merit serious attention in the context of deficit reduction, however, if they are going to be given serious attention, they deserve at least as much time as was devoted to consideration of the Tax Reform Act of 1986. Any consideration of a VAT should, of course, be done in such a way as to minimize any increases in housing costs. A BAMT, that affects all businesses in an equal way, might not be objectionable to NAHB if it returns some revenue to tax incentives such as capital gains and shorter depreciation lives for real property.

We appreciate this opportunity to submit a statement for the hearing record. We hope to be able to work closely with the Committee and its staff in finding ways to reduce this nation's budget deficit.

Because of the important relationship between tax policy and home ownership, we are submitting testimony presented on July 1, 1987, before the Senate Housing Subcommittee on the issue of homeownership.

STATEMENT

Submitted by: Danea Kehoe Martin
Counsel, Government Affairs
National Association of Life Underwriters

The National Association of Life Underwriters (NALU) thanks the Committee for the opportunity to comment on the revenue increase options presented by the staffs of the Joint Committee on Taxation and the Committee on Ways and Means. NALU is a federation of state and local life underwriter associations representing almost 135,000 professional insurance agents who sell and service life and health insurance and employee benefit plans in virtually every community in the United States.

These hearings represent the first step in the process of raising $19.3 billion in new federal revenue in FY 1988, $22 billion in FY 1989, and $23 billion in 1990, as mandated by the 1988 Budget Resolution. A number of the some 200 committee staff pamphlet (JCS-17-87) options that are the focus of these hearings raise deep-seated concerns among life underwriters. These concerns are expressed on behalf of the 70% of American adults who own life insurance as well as those who sell it.

LIFE INSURANCE TAX LAW JUST CHANGED; SHOULD NOT BE ALTERED NOW

The 12 proposals and subproposals that would change life insurance product and company tax law should all be rejected because they were debated during enactment of both the 1984 Deficit Reduction Act, (Title II, the "Stark/Moore Life Insurance Tax Law") which completely revised life insurance taxation and/or last year's tax reform legislation. Both debates focused not only on the policy underlying the various tax law provisions, but also on the appropriate level of revenue to be generated from life insurance products and companies. Further, the revenue questions were settled in the context of actual and projected Federal deficits even larger than those we currently face. The provisions are designed to produce triple the level of tax paid by the industry prior to 1984, and as yet there is no evidence to suggest a significant shortfall. The various provisions of the "Stark/Moore" life insurance tax law are scheduled for review by 1989. Preliminary studies, by the Treasury Department and the General Accounting Office, are expected this fall. As with Tax Reform itself, it is too soon to tinker with a radically new tax system because there simply has not been enough time to gather the data that will prove whether the new system is working as intended or needs adjustment. Thus, changes to life insurance tax law--if appropriate at all--are certainly unwarranted until the studies indicating how the law is working are complete. The soonest such changes should be contemplated is after Congress and the industry receive and have the opportunity to evaluate the preliminary data promised by the Treasury Department and GAO this fall.

LIFE INSURANCE OWNERSHIP TOO WIDESPREAD TO BE TERMED "LOOPHOLE" OR "SPECIAL INTEREST"

The premise that revenue should be raised via closing "loopholes" enjoyed by "special interests" should not be applied to life insurance products. Some 70% of all adults in the U.S. own an average of $63,400 of coverage per family. It is hard to characterize tax provisions affecting such a large group as serving only a "special interest." A benefit this broad-based--not to mention as justified by both tax principles and social policy--cannot seriously be termed a "loophole." Rather, any set of tax rules that affects such a huge segment of the American public would be more properly classified in the same category as "the public interest," such as the tax rates themselves, the personal exemptions and exclusions, etc. "Loophole" and "special interest" are terms that suggest that a few taxpayers, taking advantage of specialized and specific transactions, benefit at the expense of the majority. This is simply not the case with respect to life insurance products.

NALU wishes to comment specifically on proposals that can be divided into three general areas: life insurance products, employee benefits and estate tax issues.

LIFE INSURANCE PRODUCTS

There are eight proposals in the life insurance product area about which we are concerned.

LIFE INSURANCE CASH VALUES SHOULD ACCUMULATE INCOME-TAX FREE, AS UNDER CURRENT LAW

Among the revenue proposals are two suggestions to make life insurance policy cash values (the "inside buildup") subject to tax on a current basis. The first proposal suggests current tax liability for annual increases in cash values for all newly-issued life insurance policies. The second would limit the proposal to life insurance policies owned by corporations or trusts. Both would be bad tax policy, bad social policy, and ineffective as revenue-raisers.

Life insurance cash values are not "income" actually or constructively received. Rather, they are a function of the level payment method of funding the death benefit. Policyholders pay a higher premium in the early years of the policy's life, to make up for premiums that are less than necessary to fund the death benefit during the policy's later years. If death occurs prior to the policy's maturity, the cash values become part of the death benefit. If the policy is surrendered or annuitizes or if its cash values are withdrawn prior to death, the cash values are taxable to the extent they exceed basis. Thus, under current law, cash values are taxable at the time they are actually or constructively received. The only exception to this rule is the situation involving the transmutation of cash value into death benefit.

Further, the rule that allows cash values to accumulate tax-free until death or distribution is wise social policy. Life insurance is an excellent source of capital formation. It is an important foundation of millions of retirement income plans. Cash value life insurance allows its owners to guarantee that their beneficiaries will receive the death benefit even if death occurs "later"--when term insurance premiums become prohibitively expensive--rather than comparatively early in life. Finally, estimates that a current tax on accumulating cash values would raise $700 million in new federal revenue over the next three years are highly suspect. NALU believes few if any people would buy permanent insurance if they faced tax liability on its cash values--and no "real" money with which to pay that liability--in ever-increasing amounts as the policy, and policyholder, ages. Thus, the $700 million revenue projection is largely illusory.

Confining the proposal to tax currently the life insurance cash values in corporate-owned policies does not remedy the basic defects of the proposal. The same basic tax principle, i.e., that "income" is taxable when received, is violated. The same mischief with respect to capital formation occurs. To tax currently corporate-owned life insurance cash values runs the risk of similar social harm. Rather than inadequately-protected spouses and children, the result would be inadequately-protected businesses and employees. In some ways, this is even worse in that a business without sufficient capital (provided by death benefits) after the death(s) of its owner(s) and/or key employees can devastate the livelihoods of all those employed by the business. Life insurance protection for businesses, especially small businesses, is a key part of the financial security not only of the business itself, but of the people it employs. Many thousands of small businesses have remained productive enterprises after the deaths of their founders because of the financial cushion for the transition period provided by life insurance death benefits. As with individually-owned permanent life insurance, current tax on policy cash values acts as a powerful disincentive to acquire adequate amounts of death protection, creating the same illusory, but near-certain false, estimates of additional Federal revenue.

For all the reasons cited above, life insurance cash values should not become a preference item for purposes of the alternative minimum tax. Because cash values are not properly characterized as income received, they should not be taxed (until and unless they are received) under tax policy measurement-of income-principles. Further, the social good provided by life insurance warrants its current law tax treatment, just as the potential drain on government welfare programs that would result from the inadequate protection level that would likely occur should cash values become subject to current taxation justifies a continuation of current law tax treatment of permanent life insurance.

LOANS AND DISTRIBUTIONS PRIOR TO DEATH SHOULD BE TAXED AS UNDER CURRENT LAW

The options list includes three suggestions that would result in accelerleated or new tax liability as a result of policy loans or withdrawals. Two of these suggestions propose taxing life insurance as annuities are taxed; one would apply lower or no interest loan rules to life insurance loans. All three are misguided, both in terms of policy and in terms of the revenue they are estimated to raise.

A life insurance loan operates in all respects in the same way any loan operates. Market conditions dictate the interest charged on the loan, and the terms of repayment. (Since "collateral" for the loan is the death benefit or surrender value--both of which always exceed the loan value--and since both are payable in cash, a company has no need to force repayment within a specified time period. Death benefits or surrender value are sufficient guarantee of repayment.) All assets can be collateralized for their market value, rather than for their cost basis. No other loan (except annuity loans) triggers taxable gain when its proceeds exceed the asset's acquisition cost. Further, a fundamental principle of income tax law requires that a taxpayer receive his or her investment back prior to taxation of any gain upon liquidation of an asset. Thus, it is annuity law (at least with respect to the tax consequences of borrowing or taking an "early" withdrawal) that is the departure from the norm. It is bad enough that annuities are taxed on an unfair-in-principle basis. To extend that unfairness to life insurance would only exacerbate an unfortunate anomaly in the tax code.

Beyond the basic questions of fairness and soundness of the tax principles underlying life insurance product tax law there is the question of the harm to the financial security afforded to society by life insurance. Permanent life insurance is a long-term commitment that is made possible, in most cases, by the peace of mind that comes with knowing that loans or withdrawals, should they become necessary due to unforeseen or extraordinary financial events, are available on a tax basis that compares with the tax consequences of any other situation. Most frequently, the loans and/or withdrawals are either not taken or they are repaid, but their availability is a critical element in the decision to acquire a sufficient amount of life insurance protection in the first instance. Where loans or withdrawals are taken and not repaid, most often it is to keep the insurance in force. Loan and withdrawal values typically represent only a small fraction of the typical policy's death benefit.

Not only would adverse, unfair tax consequences imposed on policy loans and withdrawals depress the level of life insurance in force to potentially harmful levels (the decrease in capital formation and the increase in government subsidies to inadequately protected beneficiaries would both have long-term negative effects on our overall economy), but such a move would almost certainly fail utterly at raising the revenue the proposals estimate. It is unlikely that borrowing and withdrawing would continue at present-day levels, just as it is unlikely that the same level of life insurance (and thus borrowable and withdrawable cash values) would continue at current levels. In fact, it would not be unreasonable to anticipate a revenue loss due to the lowered tax liability of the people whose livelihoods would be diminshed as a result of any such changes, and to the increase in Federal expenditures necessitated by an increase in inadequately protected survivors, small businesses and retirees.

INVESTMENT-ORIENTED (SINGLE PREMIUM) POLICIES NEED FURTHER STUDY

The options list proposes redefining life insurance to exclude "significantly investment-oriented life insurance policies such as single premium life insurance policies." The proposal's authors generally define a "significantly investment-oriented policy" as one whose premiums are substantially in excess of the amount needed for level premium funding of the death benefit, or one whose investment income is derived from high-risk or high-return investments. NALU opposes this proposal as one that is dangerously overbroad, badly-defined and ill-conceived. NALU concedes that there may be some single premium contracts--in a class which does not include all single premium contracts--that are marketed as tax-sheltered investments. NALU is willing to work with the Ways and Means Committee to define properly the scope of any problems these policies may create, and to devise an appropriate response. However, the proposal described above is both too vague and too broad to respond to with anything but stiff opposition. It has been less than three years since Congress, after thorough study and intense debate, determined that for tax purposes life insurance should be allowed to be funded with a single payment. It is not the single payment which created the tax-sheltered investment to which some Congressional members now object. Nor is it appropriate to define life insurance by examining the investments into which a life insurance company puts its premiums dollars. In addition, such terms as "high-risk" or "high-return" investments are imprecise at best, subject to revision based on cyclical changes in the marketplace. For example, a 12% return would be considered quite high today, but 3 years ago investments yielding 12% or more were common. So, too, is the term "level funding of the death benefit" imprecise. What is "level funding?" Yearly premiums until the policy's maturity date? Yearly premiums for at least 5, 10, 15, 20 or 25 years? Yearly premiums until a certain age? Or something entirely different?

Aside from the issues presented by an overly vague proposal, the concept of redefining life insurance to exclude the single premium product would eliminate the historical, eminently justifiable use of the contract as an estate creation device. Single premium products are especially suitable to fund the cost of future education for a young child being protected by an older parent or grandparent. Thus while further study of the product as it is currently constructed, marketed and taxed is appropriate, a sweeping, destructive change of the nature proposed in the options list must be opposed. The General Accounting Office is currently conducting a study of the single premium policy, with results anticipated this fall. Also in the fall, GAO and the Treasury Department are scheduled to present to Congress preliminary data on the working of the "Stark/Moore" life insurance tax law. That is the appropriate time and context for a review of "significantly investment-oriented" policies. NALU has been working with GAO and the Ways and Means Committee on this problem, and will continue to do so. In the interim, we must oppose the proposal presented in the options list.

ANNUITIES SHOULD NOT BE TAXED MORE HARSHLY THAN AT PRESENT

As noted above, annuities are currently taxed in the harshest of ways. After-tax investment dollars must accumulate until retirement age, on pain of taxation of the investment yields before return of investment--a reversal of the usual rule--and a penalty tax. Still, annuities remain an important tool of retirement income planning. The options list suggests either making all annuity investment yields subject to tax in the year they are earned, or limiting tax-deferred accumulation of investment yields to amounts earned on investments of $50,000 or less.

This is yet another unfortunate idea. Demographic data indicate that Americans are living longer, and the fastest-growing segment of our population is the post-retirement group. This trend will increase as the "Baby Boom" generation ages into retirement. With such a trend clearly forecast, how can the government afford to undercut incentives to put away money to provide retirement income? Rather, we should be investigating additional incentives. Not only do retirement savings pump much-needed capital into the economy, they cushion the need for public support of older people after they complete their working years.

There is little or no room left for "abuse" of the annuity product. Only annuities owned by natural persons (actually or beneficially) enjoy the tax-deferred accumulation of investment earnings. Pay-out cannot be delayed beyond age 70½; pay-outs are fully taxable on a "blended" basis whereby only a portion (directly related to the ratio between investment and investment earnings) of the after-tax investment is returned prior to taxable investment income. Pre-retirement loans and withdrawals are taxed, on an investment interest first basis, and subject to a penalty tax. There is simply no justification for imposing even more restrictions on this retirement income vehicle, just as there is no wisdom in eliminating the annuity as a retirement planning tool. And again, estimates of increased revenue as a result of these proposals are largely illusory. There would be little or no market for a currently-taxable annuity, thus eliminating the possibility of generating tax dollars from its investment income. And even the revenue estimators concede only a tiny amount of revenue to be gained from limiting the size of a tax-deferred annuity to $50,000.

COMPANY RESERVE DEDUCTION IS APPROPRIATE

NALU is admittedly no source of expertise on the appropriateness of the companies' reserve deductions. However, those deductions are directly related to the value of the products themselves. In the best interest of the policyholders represented by NALU, we support the companies' opposition to any change in the current law method by which the reserve deduction is calculated.

EMPLOYEE BENEFITS

EMPLOYER-PAID LIFE AND HEALTH INSURANCE SHOULD BE EXCLUDED FROM INCOME

Enormous amounts of revenue--anywhere from $3 to $40 billion (over three years)--are contemplated from a range of proposals that would impose tax liability on employer-paid life and health insurance. The very size of the revenue estimates suggests an integral contradiction in terming tax-free employee benefits a "loophole." The great majority of working Americans (and thus an even greater majority of taxpayers!) benefit from the tax code provisions that allow them to receive life and health insurance tax-free from their employers. Elimination or restriction of this benefit is tantamount to an increase in tax rates. At a minimum such a change would kill any tax cut the average taxpayer might have gotten as a result of tax reform, and perhaps transform it into a tax increase. But beyond that, taxable insurance benefits could lead to pernicious results that would put the Federal government in the position of having to provide the protection that used to be provided by insurance. This is because employees, faced with having to pay income tax on the value of life and health insurance, would likely pressure their employers into letting them decline those benefits. Of course, the younger and healthier employees--and the lowest paid--would be most likely to reject them. Not only does this leave the government at risk for death protection in the case of life insurance and health care costs in the case of health insurance for these employees (some, albeit only a relative few, of whom will die or become expensively ill or injured), but it will also drive up the cost of insurance for those who continue to accept the coverage. This is because those remaining in the insurance pool will be the (relatively) sicker and/or older employees. As their claims continue to drive up the cost of insurance, more relatively young and healthy employees will opt out, spiking another round of adverse selection.

Further, there is basic unfairness in trying to tax these benefits. The unfairness comes from valuation problems (for example, how do you calculate the "income" attributable to a beneficiary of a self-insured plan?); from wildly varying regional costs of health care and therefore of health insurance; from differences in rates attributable to the nature of the insured group (small vs. large, high-risk vs. low-risk occupations, etc.); and from the fact that many employees would be paying tax on duplicative coverage because both spouses must accept employer-provided health insurance.

A "cap" approach discourages cost-effective preventive care protection; a "floor" approach is regressive and hits lower-paid employees the hardest. Inclusion of these benefits in the Social Security wage basis is also regressive and discriminatory against those earning less than the wage base. The proposal to tax only those who earn $50,000-60,000 or more is just plain unfair and is especially hard on the two-income couple with duplicative coverage.

The proposals to limit cafeteria plan tax-free benefits, either by amount ($500) or by forcing benefits provided under a cafeteria plan into the Social Security wage base are more limited in their potential for damage, but for cafeteria plan beneficiaries the damage is just as real. And it is unfair to single out one form for providing employee benefits as a candidate for adverse tax treatment.

PENSION LOANS SHOULD NOT BE FURTHER RESTRICTED

NALU joins in the comments submitted by our conference, the Association for Advanced Life Underwriting (AALU) with respect to the range of proposed pension changes, including the proposal to disallow (without tax penalty) any loans from a pension plan. Here, suffice it to say that we oppose these changes on the ground that it is becoming increasingly important to encourage adequate retirement planning, and these changes would discourage such planning. Further, pension law has been changed so repeatedly over the last decade that many employers are terminating or considering terminating their plans because of the expense of amending, administering and keeping up with continual changes.

ESTATE TAXES

DEATH BENEFITS PAID TO A RELATIVE SHOULD NOT BE INCLUDIBLE IN THE DECEDENT'S ESTATE

Under current law, proceeds from a life insurance policy are not includible in the decedent's taxable estate if the decedent transferred all incidents of ownership in the policy at least three years prior to death. The options list would change this, to require inclusion of death benefits in the decedent's estate, whether or not incidents of ownership were transferred in a timely fashion, if the death benefits are payable to a relative. NALU opposes this proposal.

First, relatives, mates and children especially, are among the most important of life insurance beneficiaries and also the likely heirs of the estate. Thus, this proposal is a roundabout way of taxing death benefits received by relatives. Further, relatives have their own independent insurable interest in an insured. If a child elected to purchase insurance on a parent's life, the result of this change could be increased estate tax liability on the surviving parent where the death benefit went to the child. This is manifestly unfair. As important as business-use life insurance is, to exempt a business beneficiary from estate tax liability on death benefits while imposing it on surviving spouses and children would be wrong. The two situations should be treated similarly, as they are under current law.

SUMMARY

In summary, NALU opposes the life insurance, employee benefits and estate tax proposals described above. The extent to which changes in life insurance tax law may be appropriate, for policy or revenue reasons, cannot be determined rationally until the preliminary data on how the recently-revised life insurance tax law is working has been received and evaluated. This data is expected this fall. Life insurance and employee benefits are enjoyed by such a widespread cross-section of taxpayers that any change in the law governing them would be tantamount to a tax increase. Further, the economic foundation of literally millions of Americans could be seriously weakened were any of these proposals to become law. In addition, life insurance (and pensions) provide an important source of capital to the U.S. economy. To undercut either would risk harm to the economy itself. Finally, most of these proposals would operate on an uneven basis, resulting in discrimination against older, less healthy and lower-paid individuals.

NALU thanks the committee for this opportunity to express our concerns.

Statement of the
NATIONAL ASSOCIATION OF REALTORS®
THE WORLD'S LARGEST TRADE ASSOCIATION

On behalf of the more that 730,000 members of the National Association of Realtors, we are pleased to have the opportunity to present our views on the various proposals to increase revenue for purposes of deficit reduction.

We have for several years urged the Congress to address this nation's federal budget deficit. Last year we urged that some of the revenue derived from the tax code restructuring be applied to reduce the deficit. Instead, all the revenue, a large portion of which was from the real estate industry, went to a significant reduction in individual and corporate tax rates.

Deficit reduction continues to be a goal of our Association. We are not unwilling to share in the sacrifice necessary to achieve a gradual narrowing of the deficit. However, housing and real estate investment have already participated to a very great degree in recent spending and taxation changes designed to achieve this, and other, goals. For example, budget authority for the Department of Housing and Urban Development which accounted for over 7% of the Federal Budget at the beginning of this decade is now estimated to be less than 1% of total spending. Moreover, the 1984 tax legislation enacted changes in investment real estate taxation which were, up to that point, very significant tax increases. And, finally, massive new real estate tax increases were imposed as a part of last year's Tax Reform legislation.

Certainly, we were pleased that the mortgage interest deduction for first and second homes was left largely intact last year, as was the property tax deduction. Even so, in our view, the 1986 Tax Reform Act was an unwarranted frontal attack on virtually all of the tax laws affecting real estate investment. Specifically, the Tax Reform Act increased taxes on housing and real estate investment nearly $50 billion. These new taxes included: significantly stretched out depreciation, limitations on the deductibility of "passive losses" from existing and future investments (including all losses from rental real estate even if rental real estate is the principal business of the owner/operator and including all losses even those relating to actual out-of-pocket cash expenses), elimination of capital gains, a virtual repeal of the installment method of reporting the sale of real estate, subjecting real estate to the "at risk" rules, severe limitations on interest deductions, and more.

These tax increases provided a significant portion, and we believe a disproportionate amount, of the revenue required last year to reduce overall individual and corporate tax rates. The magnitude of these new taxes has forced new investment and tax planning strategies for all transactions, not only real estate development, acquisition, operation and disposition but also regarding whether or not to purchase a home.

Those of us interested in providing affordable housing and competitive real estate investment opportunities for Americans are struggling to come to grips with these new rules. In the long run, we are optimistic that our industry can adapt to these changes. However, at this point, new construction for both residential and commercial development is at a virtual standstill and rents for existing housing are steadily increasing. For the typical renter, we estimate that the 1986 Tax Reform law represents an additional rent burden of between 3 and 5 percent of income. This will likely more than offset the benefit a typical renter could have expected from lower tax rates.

Additionally, the rate of homeownership in America is in the midst of the only sustained decline since the 1930's. All income and age groups are affected by this homeownership decline. Among married couples in the 25 to 29 age group, homeownership fell from a rate of 59 percent in 1978 to 52 percent in the first quarter of 1987. For married couples age 30 to 34, the homeownership rate dropped over the same period from 75 percent to 70 percent.

Certainly, the new tax laws are a very real source of unrest in rental housing and commercial real estate markets and they have not helped to stem the continued homeownership rate decline. New taxes on this sector of the economy will disrupt activity even more, leading to further decreases in housing affordability, greater unemployment, additional real estate foreclosures and further strain the nation's already severely weakened financial institutions. Therefore, we feel obligated to inform the Committee as strongly as we can that we do not believe that housing or real estate investment can reasonably be asked to bear another tax increase so soon after tax reform.

The following are our observations regarding specific revenue proposals now before the Committee.

HOMEOWNERSHIP PROVISIONS

The Joint Taxation Committee presents a variety of revenue raising options in its pamphlet which could increase the after-tax cost of homeownership and/or reduce the value of homes in the hands of existing homeowners. These proposals range from various caps on the amount of debt treated as "qualified residence interest" (including limits on equity lines of credit not only against appreciated home value, but against the equity created by pay down of the purchase note as well) to schemes which would limit all deductions to only the lowest marginal tax bracket.

While the 1986 Tax Reform Act largely preserved the interest deduction for first and second homes, it is important to remember that deductibility was cut back to some extent. Essentially, homeowners may deduct interest on all debt up to an amount equal to the home's purchase price plus the cost of improvements. A taxpayer may also deduct interest on debt secured by the appreciated value of the home if the debt proceeds are used for education or medical purposes. We recognize the policy goal of precluding avoidance of the disallowance of personal interest deductibility. Even so, we feel obligated to remind the Committee that a person's home is generally the largest single asset the homeowner possesses. Therefore, while we understand the reasons for last year's limits, we do not believe that further cutbacks are now desirable.

Regarding proposals to limit individual deductions to the 15% tax rate or to place a floor under all itemized deductions, these would diminish the attractiveness and incentive to homeownership and reduce the value of many homes. Moreover, in addition to decreasing homeownership incentives and arbitrarily reducing the value of many homes, these proposals should be rejected because they would further increase tax complexity for a great many taxpayers.

WITHHOLDING ON INDEPENDENT CONTRACTORS

The Joint Committee on Taxation pamphlet on revenue options proposes that a new withholding system be instituted whereby persons making payments to independent contractors would be required to withhold 10% of the payment as tax on the independent contractor's income.

Independent contractors perform services in nearly all sectors of the American economy and they operate in all industries, from law and medicine to trucking and logging, from direct sales and insurance to home improvement and construction, from gasoline marketing to entertainment. Inasmuch as there are over 200,000 real estate brokers throughout the country whose salesforce of 500,000 is predominately independent contractors, we know that this proposal would be administratively unworkable and we strongly urge that it be rejected on several grounds.

o REAL ESTATE INDEPENDENT CONTRACTORS COMPLY WITH THE TAX LAWS. This proposal is not a new one. It was last seriously debated by Congress in 1979 when a Treasury Department study purported to show that a large percentage of independent contractors do not pay their fair share of taxes. A review of the record shows that this study was totally refuted because it did not accurately define the universe of independent contractors, the sample size was statistically much too small, and those sampled were not randomly selected. Even so, a detailed analysis of the IRS study revealed that compliance with the tax laws was better than 96% among independent contractor real estate salespeople. In other words, according to IRS's own data, which was skewed to show low tax compliance, at least 96% of the compensation received by independent contractors in the real estate sales profession was reported on their tax returns. We did not see then how tax compliance could be increased through withholding and, as we are unaware of any new compliance study by Treasury, we continue to question the value of imposing withholding on independent contractors. Additionally, over the past several years we have worked with Congress to ensure the this high degree of tax compliance does not diminish. For example, we supported revisions, ultimately enacted, to the information reporting system to require brokers to file IRS Form 1099 (detailing payments made to independent contractors in the ordinary course of business) not only with the IRS but with the independent contractor salesperson as well. We believe that giving the independent contractor information showing the total renumeration received increases tax compliance in all sectors.

o INDEPENDENT CONTRACTOR WITHHOLDING WILL BE AN ADMINISTRATIVE NIGHTMARE FOR SMALL BUSINESSES IN TERMS OF COST AND PAPERWORK. The heavy administrative burden and substantial cost of an independent contractor withholding system would fall to a very large extent, on small businesses that do not already maintain employee withholding systems. This is especially true in the real estate sales industry which is dominated by firms of less than 5 salespeople. Many of these firms do not have any employees, not even a secretary or receptionist, and therefore are unfamiliar with any office withholding system. Forcing these firms to hire an accountant or bookkeeper and incur the additional expenses for paperwork, office space, etc., would obviously impose a new, unfamiliar and costly burden on those least able to survive and compete. In short, it would place yet another bureaucratic paperwork burden, and a costly one, on the small businessperson.

o WITHHOLDING ON INDEPENDENT CONTRACTORS WOULD RESULT IN A TAX ON GROSS--NOT NET INCOME. An independent contractor's income is neither fixed nor guaranteed. An independent contractor has no assurance that his income will bear any relation to the amount of time he devotes to performing his services. He may make several sales presentations and yet not make a single sale; in such a case, he would have nothing to show for all the efforts except substantial expenses. An employee's income, in contrast, is "guaranteed" in the sense that as long as the hours are worked, a specified amount of compensation will be paid. This distinction is very important to real estate salespeople who incur significant expenses in the pursuit of their livelihood. Withholding of tax on payments to independent contractors would thus be a tax on "gross" income not "net", after expenses, income and would create problems of overwithholding of income taxes. While an employee may claim additional personal exemptions on his employee withholding statement to reduce the amount withheld from his gross income, it would be very difficult, if not impossible, for a real estate salesperson to estimate the amount of future business expenses and, thus, the proper number of additional exemptions to claim.

The National Association of Realtors does not condone non-compliance by independent contractors. We believe every person should pay his or her fair share of taxes. However, we urge you to reject this withholding proposal given the high degree of tax compliance by real estate salespeople and the lack of credible non-compliance statistics for others, the heavy cost to small business operations, and the potential cash flow distortions which would likely result.

ADVERTISING EXPENSES

Among the options listed as revenue raising possibilities by the Joint Committee on Taxation is a proposal to disallow a current business expense deduction for 20% of the costs incurred during a taxable year for advertising costs. Advertising costs are costs of doing business and we urge maintaining the full current business expense deductibility of them.

The tax laws have historically recognized that taxpayers may deduct costs which are ordinary and necessary expenses in carrying on a trade, business or profession. Advertising, whether print or broadcast, is an indispensable part of the real estate sales business. In many cases, it represents the marketing function most responsible for a property sale. It enhances competition for lower, more affordable, real estate prices, as well as providing essential comparative information for potential property buyers. It enables new competing real estate sales businesses to enter markets and existing firms to present properties in new, innovative ways.

The advocates of the "advertising tax" proposals apparently rest their case on the belief that the benefits derived from advertising extend beyond the year of the expenditure and therefore the deduction for such a cost should be deferred to a later year. This belief is mistaken.

First, there is no objective way of establishing the future value of current advertising costs and therefore, any deferral of current deductibility is arbitrary. Second, many costs, (other than those for advertising) which are currently expenses annually by businesses have the potential for providing benefits beyond the year of expenditure. Examples of these expenditures include the cost of training employees, research and development expenditures, the staff and operation costs for corporate public relations departments and legal departments and the salaries and costs of long term planning departments. These expenses are simply different ways of marketing the firms products.

Firms, such as real estate, that rely heavily on advertising, rather than other marketing expenses, would unfairly have their taxes increased due to this proposal simply because of their necessary marketing techniques. Inevitably this proposal would lead to reduced real estate property sales, lost jobs, lower incomes and reduced tax payments by these firms. For the above reasons we urge you to reject any limitation on the full current deductibility of advertising costs.

FURTHER LIMITATIONS ON INSTALLMENT SALES

One of the least rational amendments made to the tax code by last year's Tax Reform Act was the evisceration of the installment sales method for reporting gain on the sale of business or rental real estate. Prior to the 1986 Tax Reform Act, sellers paid tax on the gain as payments were received. This was changed basically through an elaborate allocation process (known as the proportionate disallowance rule) which treats a part of a seller's existing outstanding indebtedness as if it were an installment payment received on the note. In effect, sellers are taxed in a manner unrelated to actual payments by buyers under a formula which is tilted in favor of wealthy sellers who have few debts and many assets.

Representative Ed Jenkins along with Representatives Pickle, Schultz, Matsui and Flippo have introduced legislative which will correct this inequitable result. Their legislation, H.R. 567, which would return non-dealers to pre-Tax Reform Act installment sales rules, has gained the co-sponsorship of over 220 House members, 24 of which are on the Ways and Means Committee. Despite the obviously oppressive nature of the Tax Reform Act installment sales rules and the disdain for them as demonstrated by the outpouring of support for H.R. 567, the Joint Taxation Committee proposes two additional revenue increase options affecting installment sales of real property. First, it is proposed that the installment sales method be repealed directly, rather than indirectly, as occurs now through the proportionate disallowance rule. Alternatively, it is proposed that non-dealers be allowed to defer tax liability until payment is received if interest is paid by the seller on the deferred tax liability.

Approximately 95% of all small business sales and about 25% of all investment property sales involve seller financed installment sales. Installment sales are even more important in rural areas where there are fewer bank financing Options and in high cost areas where seller financing has become an essential affordability technique.

While we believe revisions are necessary in the installment sales area, we strongly urge that you reject the options listed in the Joint Taxation pamphlet and instead urge you to support the Jenkins bill, H.R. 567, which would return non-dealers to the rules that existed before the 1986 Tax Reform Act. Many transactions are currently unable to close because sellers are unable to pay the initial tax liability caused by the proportionate disallowance rule. H.R. 567 would remove this "phantom income" problem thus enabling transactions to go forward. Gain under H.R. 567 would continue to be taxed. However, taxation would occur when payment by the buyer occurred.

The proposal to allow a deferral of income tax liability if interest is paid to the IRS is a modest improvement over the proportionate disallowance rule. However, taxation should not occur until payment has been received from the buyer. Therefore, a deferral is not inappropriate and interest assessments against the seller are unwarranted. The truly rational system for taxing installment sales is the system which was in effect prior to the Tax Reform Act.

MASTER LIMITED PARTNERSHIPS

The pamphlet contains a number of proposals to tax as a corporation either publicly-traded limited partnerships or certain publicly-registered limited partnerships. The National Association of Realtors strongly opposes these proposals for reasons discussed in detail in a statement submitted to the Ways and Means Subcommittee on Select Revenue Measures at a hearing held on Master Limited Partnerships July 1, 1987.

To briefly summarize, the position of the NATIONAL ASSOCIATION OF REALTORS® is that the tax treatment of limited partnerships, including Master Limited Partnerships (MLPs), should be maintained.

PARTNERSHIP ALLOCATIONS

Another set of proposals contained in the Joint Tax pamphlet would place a variety of additional restrictions on the validity for Federal income tax purposes of special partnership allocations of income, deductions, gain, loss, or credits. One proposal would disallow allocations of income, loss, gain, deductions, or credits that vary during the conduct of the partnership's business. The proposal would require that allocations for tax purposes be in accordance with the partner's interests in the partnership even if the economic substance of the agreement between the partners were entirely different. Other proposals would restrict the use of special partnership allocations for tax purposes where the partnership includes both taxable and tax-exempt partners. One such proposal would require taxable partners to report as income the amount determined by their percentage interest in the partnership even if the amount actually received were loss. Another proposal would permit allocations of losses to taxable partners to be respected up to a threshold percentage (Ex. 35%) if the general percentage interest between the taxable and tax-exempt were followed with respect to other partnership tax items. A variation on this last proposal would require that payments to either tax-exempt organizations or taxable entities on debt or for the performance of services would be taken into account in determining whether partnership allocations had substantial economic effect.

The various proposals regarding partnership allocations that are described above should be rejected for several reasons.

First, a proposal that did not respect an allocation of income, deduction, etc... which varied from the general percentage interest held by each partner would distort the economic terms of the partnership agreement entered into by the parties. For example, if the general percentage interests in a partnership are 90% - A and 10% - B, but A and B split the net proceeds from a sale of partnership property, it would be a distortion of the financial agreement between the parties and would produce an inequitable result if A, who received 50% of the proceeds, were required to recognize 90% of the gain on the transaction, while B recognized only 10% of the gain, but received 50% of the proceeds. On the other hand, if the proposal contained in the pamphlet implicitly is suggesting that a "weighted" percentage be determined for each partner based upon their varying interests in each item of partnership income, loss, etc..., then such an approach would inject considerable uncertainty into the planning of partnership business activities and the tax consequences arising from such activities.

Secondly, because of the prevalent use in real estate partnerships of special allocations to meet the diverse, economic needs of various partners in a real estate transaction, any of the proposed revisions to the partnership allocation rules contained in Section 704(b) of the Code would represent a new, tax increase on investment real estate in addition to the $50 to $60 billion of tax increases imposed on the real estate industry in the Tax Reform Act of 1986. Since it is quite unusual for the development and ownership of rental real estate owned by a partnership not to involve a special allocation of various items of partnership income, loss, etc..., a proposal that caused one or more partners to treat an allocation for tax purposes differently than the economics of the allocation dictates would work a hardship on some partners while creating a windfall for other partners.

Thirdly, the purported justification for the proposals provides that revisions to the special allocation rules would prevent the "selling of tax benefits" among partners. This reference is clearly mistaken. In light of the enactment of the 1986 tax bill, which repealed tax incentives for investment real estate, the ability to "sell tax benefits" by invoking the special allocation partnership rules has been virtually negated. There simply are few, if any remaining tax benefits associated with the ownership by a partnership of rental real estate that can be "bought or sold" through partnership allocations. In short, any perceived tax abuses have been directly addressed in the 1986 tax bill and attempts to alter the tax rules governing partnership allocations would represent overkill.

And finally, the various proposals contained in the pamphlet should be rejected as redundant and unnecessary in view of the revisions to the partnership allocations rules contained in the 1976 Tax Reform Act and the recently finalized regulations promulgated by the Treasury Department under Section 704(b). These regulations, which were issued in proposed form and have been the object of considerable input from tax practitioners, generally require that a special allocation must have substantial economic effect if the allocation is to be respected for tax purposes. Moreover, practitioners have given these regulations favorable reviews from the standpoint of workability and for realizing the legislative intent behind the provision. Accordingly, there simply is no need to revisit an area of taxation, such as partnership allocations, that has only recently been the subject of a thorough and intense study spanning more than three years.

UNRELATED BUSINESS INCOME TAX-EQUITY KICKERS ON LOANS TO BUSINESS VENTURES

Another proposal contained in the pamphlet would characterize the income received by tax-exempt organizations as unrelated business taxable income (UBTI) in those cases where a tax-exempt partner receives an equity-kicker in the net profits of the venture.

Current law treats the business income of a tax-exempt organization as unrelated business taxable income (UBTI) if the income is attributable to an equity investment in a partnership. However, an exemption exists from UBTI characterization for passive investment income, including interest and dividends. The proposal in the pamphlet would reverse this result to characterize as UBTI all income received by a tax-exempt organization if the tax-exempt entity has made a loan to the venture and will receive an equity-kicker from the sale or disposition of the partnership or venture property.

This proposal should be rejected for a number of reasons. First, the proposal would deal the real estate industry another serious setback in addition to the Tax Reform Act of 1986, which raised taxes on real estate investment by roughly $50 billion. The practical effect of the proposal would be to deny real estate construction access to tax-exempt lenders, such as pension funds, which make loans to real estate ventures, including multi-family housing projects, shopping centers, and office buildings, but only on the condition that the tax-exempt organization, like most permanent lenders, can receive a percentage of the profits or an equity-kicker on the sale of the property. Because the use of "equity-kickers" is a customary practice presently only in the case of real estate loans, the proposal to tax as UBTI all net income of a tax-exempt lender where an equity-kicker is involved is unfairly aimed at real estate.

Secondly, by causing the tax-exempt entity to pay income tax on the net income characterized as UBTI from a loan with an equity-kicker, the proposal would harm the net retirement for pension beneficiaries. Thus, the proposal runs contrary to the longstanding Congressional policy of allowing retirement income to accumulate tax-free to increase the amount of retirement income available to beneficiaries.

And lastly, the proposal should be rejected as inequitably subjecting tax-exempt organizations to a less favorable standard under the general debt/equity rules of the law than is the case for other lenders who receive equity-kickers. In most instances, a taxable lender with an equity-kicker is treated as a lender for tax purposes and not as an equity holder. The proposal would change this outcome for tax-exempt lenders only by treating all of the net income as business/equity income and not passive investment income exempt from the UBTI.

TRANSACTIONS BETWEEN PARTNERS AND PARTNERSHIPS

The pamphlet also contains a proposal that would treat a partner who contributes encumbered property to a partnership as if he sold the property to the extent the debt is reduced or retired and cash is contributed to the partnership by newly admitted partners.

This proposal should be opposed on the grounds that it runs contrary to one of the primary objectives behind the 1986 Tax Reform Act, which was to discourage debt-financed purchases of property and to reduce or retire the indebtedness on existing property. By creating the legal fiction of a taxable exchange to the partner contributing property where equity capital contributed by another partner is used to retire or reduce outstanding debt on contributed property, the proposal would discourage the reduction or retirement of debt on existing properties by treating the contributing partner as if he had sold the property in an amount equal to the debt that is reduced or retired. The proposal also departs from the treatment of a partnership as an entity in this area of partnership and instead wrongly treats the partners as if they were dealing directly with each other. Moreover, the proposal could create a liquidity problem for the partner contributing the encumbered property by treating him as if he sold the property without having the cash to pay the tax on the imputed gain. Furthermore, the one situation where such a result may be justified is adequately covered by the step-transaction doctrine of current law - i.e. - where a property is encumbered immediately before its transfer to a partnership.

PARTNERSHIP-LEVEL INCOME COMPUTATION

A proposal in the pamphlet would revise the tax treatment of limited partnerships to more closely resemble that of a REIT. Under the proposal, income to the partners would be treated as portfolio income and not passive income, while any deductions, losses, or credits generated by the partnership would not pass through to the partners.

The National Association of Realtors submitted a detailed statement on July 1, 1987 in connection with a hearing on Master Limited Partnerships in which the reasons for its strong opposition to this proposal are discussed. However, to chiefly summarize, first the proposal should be rejected as a new, unwarranted tax increase on investment real estate beyond the sizable tax increases imposed on the real estate industry in the 1986 Tax Reform Act.

Secondly, if perceived abuses existed before passage of the 1986 tax bill, adoption of the passive loss limitation prevents taxpayers from deducting tax losses from rental real estate against income other than rental or other passive income. By preventing the deduction of losses from one partnership owning rental real estate against the income from another partnership, the proposal distorts the economic, after-tax effects of a taxpayer who has invested in a number of different partnerships, some of which are profitable and others which are unprofitable.

Thirdly, the proposal to treat rental real estate income owned by a partnership as portfolio income moves in the wrong direction from a policy standpoint. Instead of converting all partnership income from passive into portfolio income, the proposal should treat REIT income as passive income, which present law mandates for rental real estate. Otherwise, this proposal represents a "heads I win, tails you lose" proposition for the Treasury Department regarding the tax treatment of real estate investors, particularly when viewed in conjunction with the aspect of the proposal that denies the pass-through of tax losses to investors.

And finally, if this proposal is accepted, then the resulting entity must have the flexibility that partnerships possess and that REITs currently lack. The REIT attributes which must be avoided include the restrictions on REIT qualification rules, the current asset investment restrictions imposed on the operation of a REIT, and the inability to have different allocations of income and loss to owners which the partnership rules presently allow.

LIKE-KIND EXCHANGES

One proposal in the pamphlet would prevent investment real estate from receiving the benefit of nonrecognition tax treatment on a like-kind exchange under Section 1031 of the Code. A variation on this proposal would revise the requirements for a like-kind exchange of investment real estate to mandate that nonrecognition treatment will apply only if the properties are similar or related in service or use to each other.

Current law permits an exchange of real estate to be nontaxable if real estate that is investment property or property used in a trade or business is transferred for property of a like-kind. While the like-kind standard permits the tax-free exchange of improved real estate for unimproved real estate, the proposed test requiring that the two properties be similar in service of use would reverse that result.

The proposed revisions to the like-kind exchange rules for real estate should be rejected for a number of reasons.

First, taxation should not be imposed on a transaction in which the taxpayer has not materially altered the form of his investment. A taxpayer who transfers improved for unimproved real estate does not pay tax on this exchange under the current rules (in the absence of cash or excess liabilities). This result is reasonable in view of the fact that the taxpayer has only slightly modified the nature of his investment. Should the fact that improvements have been made on the property transform a nontaxable exchange into one that is taxable? This result makes little sense and should be rejected.

Secondly, the proposal would vitiate a vital technique for the acquisition of investment real estate, especially in times when capital is in short supply and interest rates are high. In many instances, like-kind exchanges are utilized when the parties simply could not afford the costs of paying the tax if a straight sale were made and could not arrange financing through conventional sources. Thus, the effect of such a proposal would be to deter many such transactions to the detriment of the real estate industry and the economy in general.

Thirdly, subjecting a like-kind exchange of real estate to tax could cause a severe liquidity problem for one or more parties to the exchange. Since limited amounts of cash may be involved in a like-kind exchange, the proposal could cause one or more parties to pay a tax on the exchange without the cash to make the tax payment.

INDIVIDUAL CAPITAL GAINS

The pamphlet contains a proposal to tax net, long-term capital gains for individuals at a maximum rate of 15 percent. The Tax Reform Act of 1986 repealed the capital gains exclusion, beginning in 1988, causing gain from the sale of investment assets or income-producing property to be taxed at ordinary income rates. The NATIONAL ASSOCIATION OF REALTORS® offers strong support (with a caveat noted below) for restoration of a lower tax on the sale of investment assets or income-producing property for reasons discussed below.

First, a lower tax on the sale of investment assets or income-producing property would promote economic growth by encouraging the sale of appreciated assets. Evidence based on the effects of the lower capital gains tax rates enacted in 1978 and 1981 suggest that lower taxes on the sale of so-called capital gains assets will provoke a flurry of sales activity that could lead to increased tax revenues for the U.S. Treasury.

Secondly, the current tax treatment of gain from the sale of capital gains assets subjects "inflationary" gain to the ordinary income rates, which tends to cause investors to hold onto their assets for a longer period than would otherwise be the case. A tax on capital gains assets that is lower than the ordinary income has always been justified in part by a recognition that gain on the sale of an asset was partially a function of inflation during the years that the asset was held. To tax inflated gain at ordinary income rates will stem the flow of capital into investment properties and slow down economic growth. Conversely, a lower tax on the sale of capital gains property would provide an incentive to investors to engage in risk-taking ventures that promote employment and financial activity.

However, the **NATIONAL ASSOCIATION OF REALTORS®** is concerned that the rules concerning recapture of depreciation on the sale of income-producing real estate that were part of the law prior to the 1986 Tax Reform Act be reinstated if a lower capital gains rate is adopted. Under prior law, gain on the sale of income-producing real estate was taxed as a capital gain if the seller had elected to depreciate the property using the straight-line method. If an accelerated method of depreciation were elected, then the seller was taxed at ordinary income rates up to the amount of gain on the excess of accelerated depreciation over straight-line depreciation. Since the 1986 tax bill allows only straight-line depreciation over a longer recovery period than previously was the case, enactment of a lower capital gains rate, such as a 15 percent maximum, should be coupled with a proposal to tax as capital gain all appreciation on income-producing real estate in excess of the property's basis.

REPEAL OF THE "STEPPED-UP BASIS" RULE

The pamphlet contains a number of proposals that either repeal or severely curtail the rule under present law concerning the basis of property passing to the heirs from a decedent's estate. Current law provides that the basis of inherited property is "stepped-up" to the fair market value on the date of the decedent's death. The proposals would either tax the appreciation in property at death or allow the heirs to receive a carryover basis equal to the basis that the decedent had in the property prior to his demise. One proposal would tax the appreciation at death in excess of the basis, while granting a credit against the tax for any unused portion of the decedent's unified estate and gift tax credit. A variation on this proposal would provide a partial credit against any Federal estate tax owed by the estate for the basis of the decedent's property includible in his gross estate. However, this proposal would be coupled with an increase in the estate tax rates in order to achieve revenue neutrality. Another proposal would provide a carryover basis for property passing to the surviving spouse, while other appreciated property would be fully taxed. The proposal requiring a carryover basis for inherited property is presumably modeled after the carryover basis provision that was adopted as part of the 1976 Tax Reform Act and repealed in 1980.

The proposals to either tax at death the appreciation in the value of property in excess of basis or to require a carryover basis for inherited property should be rejected for several reasons.

First, the proposals to tax appreciated property at death could cause a dire liquidity problem for many estates which have properties possessing substantial appreciation. A proposal, which causes estates that owe significant estate tax liability to pay a further tax under the Federal income tax laws for appreciated property, could lead to sales of property simply to generate the cash to pay both taxes. Moreover, such a proposal could work a severe hardship on family farms, which quite often are "land-poor" with properties having values in excess of basis and little cash to pay either the estate tax or any new tax on appreciation.

Secondly, the proposal to provide a carryover basis for inherited property represents a feeble attempt to resurrect a thoroughly discredited proposal that was briefly a part of the law in the late 1970s. The carryover basis provision, which was adopted as part of the Tax Reform Act of 1976, required an heir to use the basis, with certain adjustments, that the decedent had in property before his death. The appreciation in value of the property would be taxed upon a subsequent sale of the property by the heir. The carryover basis provision was so unpopular that the effective date of the provision was deferred by legislation in 1978 and then subsequently repealed by legislation enacted in 1980.

There is no reason to believe that the carryover basis proposal has gained any wider acceptance since its repeal in 1980. In fact, the reasons for its short life at that time are even more valid today. Foremost among those reasons is the "lock-in" effect that the carryover basis creates. If property possesses substantial appreciation, the carryover basis can cause an heir to hold on to property beyond the normal holding period for an asset simply to avoid payment of a substantial tax on the sale of appreciated property. This statement is even more true after passage of the Tax Reform Act of 1986, which repealed the capital gains exclusion and imposes an even higher tax on gain from the sale of appreciated assets. Moreover, the "lock-in" effect caused by the carryover basis provision distorts the investment decisions and marketing patterns of investors and should be rejected.

NATIONAL AUTOMOBILE DEALERS ASSOCIATION

COMMENTS ON REVENUE OPTIONS

As the markup on revenue options approaches, the National Automobile Dealers Association ("NADA") is becoming increasingly concerned about the prospect of the adoption of certain new anti-consumer and anti-small business tax provisions. The three proposals we are most concerned about are (i) the proposal to impose an excise tax on a portion of the cost of certain automobiles; (ii) the proposal to require amortization of a part of a taxpayer's advertising costs; and (iii) the proposal to repeal the stepped-up basis at death rules.

Proposed Excise Tax on Certain Automobiles

NADA is opposed to the proposal to impose a 10% excise tax on a portion of the cost of automobiles priced in excess of $20,000. This tax would increase the cost of these automobiles, which would have a negative impact on sales and on the economy as a whole. When prices are driven higher by the imposition of this excise tax, sales will undoubtedly be affected and workers' jobs endangered. This is an especially serious issue since one of the industries the Committee has targeted, the automobile industry, employs, directly or indirectly, nearly one-sixth of the American work force.

NADA is especially troubled by this proposal because it targets the automobile business. During the past several years, Congress has enacted a number of tax provisions that have hurt retail automobile sales in this country. First, with the so-called "luxury" car provisions, Congress singled out cars used in a trade or a business and denied them the favorable treatment afforded other tangible assets used in a trade or business. (The cars affected by this provision include low and moderate priced cars.) Second, despite the fact that for virtually all Americans an automobile is a necessity and not a luxury item, in the Tax Reform Act of 1986 Congress denied consumers the benefit of the interest deduction for interest expense incurred in connection with the purchase of an automobile. (At the same time, Congress permitted wealthy individuals to deduct interest on vacation homes.) NADA recognizes that given the magnitude of the nation's budget problem, every sector of the economy must give up its fair share. NADA, however, strongly urges the Committee to recognize the costs recent tax legislation has already imposed on America's consumers and automobile dealers.

Finally, NADA encourages the Committee to recognize that a $20,000 car is not really a luxury item that should be subject to a luxury tax. The average price of a full size Chevrolet station wagon, a typical family car, approaches $20,000. For most Americans, this type of automobile is a necessity, not a luxury.

Proposed Limitation on Deductibility of Advertising Expense

NADA similarly urges the Committee to reject the proposal to require that part or all of a taxpayer's advertising costs be capitalized and amortized over some period of time. The proposal is based on the premise that the benefits derived from advertising extend beyond the year of the expenditure. This premise, at least as regards automobile dealers, is fundamentally wrong. NADA submits that advertising costs are costs of selling a product in the year in which the product is sold. In the highly competitive automobile business, advertisements focus on the product that is currently available and the price of that product at the current time. In this highly mobile society, with consumers purchasing cars on average only once every four to five years, it would make little sense for a dealer to spend advertising dollars on the long term benefits of doing business with it time and again. Thus, at least from an auto dealer's perspective, implementation of the proposal would amount to a partial transformation of the corporate income tax from a net income tax to a gross revenues tax without a corresponding reduction in tax rates. Obviously, this would result in a huge, disproportionate tax increase for most dealers.

NADA also urges the Committee to consider the impact of the adoption of this proposal on the American consumer. First, it would increase the cost of all automobiles regardless of price or luxury. In other words, from the perspective of the consumer, the adoption of the rule would represent the imposition of a regressive tax by increasing the cost of a necessity. Second, advertising provides important benefits to consumers by making them better aware of the products that are available in the marketplace and the price they should pay for such products. Tax rules that serve as a disincentive to advertise ultimately would limit consumer access to important information.

Proposed Elimination of the "Stepped-Up Basis" Rule

Finally, NADA submits that the alternate proposals for repeal of the "stepped-up basis" rule for property transferred at death should be rejected. First, the present system of "stepped-up basis" is workable. In contrast, the system that would result if a carryover basis rule is adopted would not be workable. Property passing at death may not be sold until years after such death. At that time, the calculation of the basis of the property would depend upon the existence of records of expenditures made by the decedent over the years. Few persons are in the habit of maintaining these kinds of records. Moreover, even if adequate records existed, there is no reason to believe that the taxpayer would have access to such records. In the absence of records, determining the basis of the decedent's property would prove virtually impossible. The same problem arises if the current rule is repealed in favor of one requiring recognition of gain at death; proper measurement of gain will turn on records that are not likely to be readily available.

More importantly, if a rule requiring recognition of gain at death is adopted, and the transfer of business property at death is subject to double (income and estate) taxation, the ability of families to transfer small businesses from generation-to-generation and keep such businesses both viable and in the family would be severely limited. NADA submits that the issue here is whether the Congress should discourage the transfer of family businesses from generation-to-generation. If not, the proposal to repeal the current stepped-up basis rule should be rejected. NADA strongly urges the Committee to recognize the important role that family businesses play in our society and reject the current proposal.

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NADA also notes that the Committee is considering a provision that would treat trade associations like social clubs for purposes of the Unrelated Business Income Tax ("UBIT"). NADA urges the Committee to clarify the proposal and ensure that income from legitimate conventions attended primarily by trade association members will not be subject to UBIT. Since there is no logical distinction between membership fees paid by members and amounts paid by members at conventions for services provided by the trade association that are consistent with its exempt purpose, this clarification would not alter the intent of the proposal, but would provide trade associations only deriving income from the provision of related services to members with clear guidance as to the application of the proposal.

STATEMENT OF THE
NATIONAL COUNCIL OF SAVINGS INSTITUTIONS

WAYS AND MEANS COMMITTEE
U.S. HOUSE OF REPRESENTATIVES
HEARINGS ON
REVENUE INCREASE OPTIONS

JULY 15, 1987

The National Council of Savings Institutions appreciates the opportunity to submit for the record its comments on revenue increase options outlined in the Joint Committee Pamphlet, "Description of Possible Options to Increase Revenues", June 25, 1987. The National Council is a trade association representing approximately 600 savings banks and savings and loan associations with total assets of $450 billion. Our members include both FDIC and FSLIC-insured institutions.

INTRODUCTION

Members of the National Council are concerned over a number of the options outlined in the Joint Taxation Committee publication on revenue raising options. These include the following proposals: 1) Limitations on the deductibility of interest for home equity loans; 2) Modification of the treatment of recoveries of foreclosed property; 3) Changes in the amortization of intangibles such as core deposits of financial institutions; 4) Reduction of the dividends received deduction; 5) Imposition of a 30 percent withholding tax on interest income paid to foreign investors; and 6) Imposition of a securities transfer tax (STET). Other issues outlined in the document may be of concern to members of the National Council, but are under study at this time.

While the specific issues of concern will be discussed below, we would like to express a general observation regarding tax legislation. Members of the National Council would prefer to see the development of very few new tax changes in 1987. First, the thrift industry is still in throes of restructuring and needs the stability to complete that restructuring. As members of this Committee know, there are many problem institutions to be dealt with. The legislation to restructure the Federal Savings and Loan Insurance Corporation (FSLIC) is near completion. While tax changes may not directly affect the restructuring, any change (particularly negative ones) creates confusion and diverts resources. Further, the thrift industry is (as are other taxpayers) still adjusting to the massive changes contained in the "Tax Reform Act of 1986". Our members are still involved in strategic planning to incorporate the provisions of this landmark Act and, in fact, are still awaiting many of the regulations which will implement this Act. Taxpayers need time to incorporate the current changes without worrying about modification of the rules. For these reasons, we urge the Committee to be judicious as it develops reconciliation legislation.

DEDUCTIBILITY OF INTEREST ON HOME EQUITY LOANS

One of the options contained in the Joint Taxation Committee print relates to the deductibilty of interest on home equity loans. The document lists five options for limiting the deductibility of interest on home equity loans. While some of the options may be preferable to others, the National Council would urge the Committee not to repeal or limit the deductible status of this interest. We do this because we believe this is a product that allows middle class taxpayers to tap the equity in their home for worthy purposes without incurring the trouble and expense of selling their home or of filing separate loan documents for each transaction. Home equity loans provide flexibility to both the homeowner and the lender to structure loans which meet the specific goals of the homeowner. For our members home equity loans are good products and we believe we can market such loans regardless of the tax status. We express our concern, however, because the customer finds the deductibility of the interest on such loans to be desirable.

While we urge no action on this item, we would like to share our thoughts and concerns on the structure in the event the Committee feels it necessary to modify the provisions enacted last year. First, any structural changes should result in increased simplicity for the taxpayer and the lender. Option five which would deny the deductibility for boats and mobile homes as second residences would be an administrative nightmare for the Internal Revenue Service as well as the consumer. Second, changes should not stifle the innovation of the marketplace in developing products. Option three which limits deductions to home equity loans with a fixed term would stifle products designed to provide convenience and lower costs to the homeowner. In addition, such a provision would increase confusion for the taxpayer. Option one would arbitrarily change the rules homeowners have depended upon and would be difficult to administer.

RECOVERIES OF BAD DEBTS OF THRIFT INSTITUTIONS

The publication outlining revenue options includes a provision which would modify the treatment of recoveries of bad debts by thrift institutions. Under the proposal, amounts realized upon the disposition of property acquired by foreclosure or property which was used as security for a loan would be attributable to the bad debt reserve only up to the institution's basis in the loan. Amounts in excess of basis would be taxed as ordinary income. The National Council would oppose this change. As we indicated in the introduction to this statement, thrift institutions are in a period of restructuring and are working to solve the difficulties created by problem institutions. Given this scenario and the current difficulties in disposing of foreclosed property in many localities, we do not believe it is the time to modify these rules. If the committee believes modifications in this area are necessary, we will be happy to discuss possible alternatives.

AMORTIZATION OF INTANGIBLES

Item 6.i. of the Revenue Options pamphlet deals with an area of great complexity. This relates to the tax treatment allowing amortization or depreciation of intangible items. The pamphlet contains possible proposals which would deny amortization deductions for intantigible assets representing the value of the existing customer base or market share or, as an alternative, would permit amortization of such intangible assets only over a prescribed period of substantial duration. One of the intangible items affected by this provision are the core deposits of financial institutions.

The core deposit question has been one of long-standing controversy. The National Council believes that this controversy is unfounded. The Financial Accounting Standards Board (FASB), and the banking regulators have recognized core deposits as separate from goodwill. Core deposits have value as a future income stream. In acquisitions, mergers, branch purchases and other similar transactions, core deposits have value which is paid for and a useful life which can be determined. It is possible to look at the history of the deposits of an entire institution or branch and determine the stability of the deposits, the rate of interest paid on deposits and develop an estimate of what the value of the deposits to the acquiring institution would be. Core deposits are distinguishable from goodwill and have a reasonably estimable useful life.

Currently, there are a number of acquisitions and mergers of financial institutions occuring. This is especially true of the thrift industry as it works it way back to profitability. An additional part of the streamlining process includes sales of branches which do not fit into a particular institution's plan or operations. In these transactions a value will be placed on and a price paid for certain deposits and an amortization deduction should be allowed for any expected future decline in the customer base. To require a lengthening in the time period over which the attrition in the core deposits must be amortized, places tax policy directly at odds with book and regulatory requirements under which institutions must write off these costs over a shorter period of time.

DIVIDEND RECEIVED DEDUCTION

One of the options contained in the Joint Taxation Committee Print relates to the dividends received deduction allowed under current law. The pamphlet suggests that the deduction could be limited for newly issued stock that does not rise to level of direct investment in the underlying business or, alternatively, the current 80 percent deduction could be substantially reduced. The National Council would question the wisdom of making such a change and suggests a close evaluation of the impact. This is especially true given the fact that changes were made in this area as recently as the Tax Reform Act. Given the concerns over capitalization of a number of companies, including thrift institutions, and over the already existing double taxation of corporate income, we urge retention of the dividend received deduction.

IMPOSITION OF A WITHHOLDING TAX ON INTEREST PAID TO FOREIGNERS

The "Description of Possible Options To Increase Revenues" contains a proposal to reinstate a withholding tax on U.S. interest paid to foreign investors. While the document includes no recommended level of withholding, until 1984 there was a withholding tax of 30 percent on such interest. The National Council strongly opposes any reinstatement of the withholding tax on interest paid to foreign investors.

The National Council members oppose the reimposition of this withholding tax because it would adversely affect the ability of our member institutions to raise funds in the international capital markets. Such foreign investment has allowed thrift institutions to sell mortgage-related debt at attractive rates. Reinstatment of the withholding tax would force thrift institutions and other corporate borrowers to compete only in the domestic market. This would result in higher domestic interest rates and increase the cost of funding mortgage portfolios. The critical nature and sensitivity of the international markets was dramatically demonstrated following the June 29 announcement by the U.S. Treasury Department that it was terminating the Netherlands Antilles Treaty. There was an immediate drop in the price of all offshore bonds and an immediate freeze in the trading of savings institution bonds outstanding. We do not believe reimposition of the tax or other disruptions of the market are desirable at this time.

SECURITIES TRANSACTION EXCISE TAX

One of the options discussed in the Joint Tax document on revenue raisers and one which has received a great deal of publicity is the possibility of imposing a securities transfer excise tax (STET). The proposal suggests that such a tax could be assessed at a level of 0.5 or 1.0 percent of value upon transfers of certain securities. While the document does not outline the technical workings of a STET, the National Council is concerned over the possible structure and reach of any provision which would be imposed. Our concern is two-fold. Many of our member institutions are converting from mutual to stock in order to increase capital to meet regulatory net worth requirement? The imposition of a STET at this point would raise the cost of obtaining capital and could, depending on the structure, make it more difficult to sell the stock of thrifts. Secondly, we would be concerned over the imposition of the transfer tax on mortgage-backed securities and other vehicles used by the thrift industry to fund home mortgage lending. Further, our members would be concerned over the reach of a securities transfer tax in terms of its extension to a wide range of investment vehicles in the name of equity.

The National Council would also be concerned over the effect of the STET on the economy and investment in general. Such tax could result in distortions in the market. While the Council does not keep statistics on the income level of investors in stock, bonds and other securities, others have indicated that many are held by middle income Americans, pension funds and other entities. It is not clear that imposition of such a tax would affect only the upper income taxpayer as some evidently believe.

CONCLUSION

The National Council appreciates the opportunity to share our concerns with the Ways and Means Committee. We recognize the the task of finding the increased revenue mandated by the Budget Resolution is a difficult one. We ask, however, that the Committee give full consideration to the impact of proposals suggested in the "Description of Possible Options to Increase Revenue" upon thrift institutions and the economy in which thrifts operate.

STATEMENT OF

JOHN J. MOTLEY III
DIRECTOR OF FEDERAL GOVERNMENTAL RELATIONS

NFIB

Before: HOUSE WAYS AND MEANS COMMITTEE

Subject: REVENUE RAISING OPTIONS

Date: JULY 9, 1987

Mr. Chairman, on behalf of the more than 500,000 small business owner-members of NFIB, I submit this statement for the official hearing record, outlining the concerns of our membership with respect to the committee's instructions to raise revenues for the Budget Reconciliation.

Polling of NFIB members on budgetary issues consistently indicates overwhelming agreement among small business owners that federal spending is out of control, that the nation's deficit is cause for alarm and is largely responsible for high interest rates and tight credit markets.

Despite concern over deficits, small business does not buy the charge that tax cuts and tax reform are the principal culprit, nor do they agree with extreme supply siders. Two thirds do not believe continued economic growth will eliminate the deficit, however there is virtual unanimity that a strong economy will reduce it.

Revenues have played a role in deficit reduction. According to a CBO analysis, total revenue increases since 1985 represent 22% of the 1987 deficit reduction, more than equal to the cuts in non-defense discretionary spending.

However, NFIB members are persistent in their opinion that deficit reductions should be achieved primarily through spending reductions. Preliminary results of our most recent Mandate ballot reveal that 71% of the NFIB membership want Congress to reduce the deficit through reductions in spending, not through new taxes or increases in current taxes.

Under the budget agreement recently reached, the House Ways and Means Committee is charged with finding some combination of tax increases or spending reductions to achieve budget savings of approximately $20 billion in fiscal 1988. Potential tax increases are always a concern to small business owners, and it is important that you know the impact on smaller firms of certain revenue raising options you are considering.

It is surely not necessary to remind the Committee about the massive tax reform exercise which was completed just last October. The Tax Reform Act of 1986 was the culmination of an exhaustive, two-year exercise. It may not be the most perfect document from the perspective of small business, but it was the best bill that could be achieved given the political and budgetary constraints that had to be met.

The Tax Reform Act of 1986 (TRA) represents the single largest reform of the Internal Revenue Code since the 1954 code revision. The Internal Revenue Service has just begun to release temporary guidance on its implementation, and the Congress has yet to consider a sizeable technical corrections bill.

Small business owners are deeply disturbed by the prospect of Congress substantively reopening tax reform; in particular there is great concern over reports that Congress may adjust the tax rates enacted in the TRA.

They are still confused about how tax reform affects them as both business owners and individual taxpayers. A significant new tax bill within six months of passage of major tax reform before that bill is even fully implemented is completely unwarranted.

Among the possible revenue options proposed by the Joint Committee on Taxation, the following items are of greatest concern to small business owners.

Tax Rate Issues

Based on a very recent survey of NFIB members, small business owners wish to send Congress one very plain message:

DO NOT CHANGE THE TAX RATES PASSED IN TAX REFORM!

NFIB's support for tax reform was substantially based on lowering corporate and individual tax rates. Enactment of lower tax rates was the inducement for eliminating the investment tax credit--a particularly important tax incentive for small firms. Any attempt to change the rates will be seen as a breach of faith with the small business community

Tax rate changes include any of the following:

- Delay in implementation of the corporate or individual rates
- Proposing a surcharge on the corporate or individual rates
- A straight increase in the corporate or individual rates which were enacted in the Tax Reform Act of 1986
- Any changes in the indexing of tax rates.

Increases in tax rates would discriminate against small business owners because small business owners in the lowest tax brackets received the least amount of tax relief in the TRA. Prior to tax reform, a corporation with $25,000 or less of taxable income paid a 15% tax rate; the TRA did not change this rate. However, this taxpayer now no longer benefits from the investment tax credit or several other provisions he might have benefitted from under the previous Code.

A surcharge, contrary to popular belief, would be particularly unfair to small business. The result of a surcharge on the lowest bracket taxpayers would be an effective increase in tax rates. Such an increase would have a devastating impact on corporations with $25,000 or less in taxable income -- approximately 50% of all corporations in the United States.

Within the complex framework of tax rate reductions and reforms in the tax code, the structure of the reduced rates was discussed, and amendments were proposed and defeated by handsome margins in both the House and the Senate. Any revision of the rates so soon after passage of tax reform -- before any reasonable analysis can be made of the impact of tax reform on taxpayers -- is bad tax policy because it is bad economic policy.

Small business owners insist that tax rate increases not be a part of the debate over revenue raising in this budget reconciliation bill.

Estate Taxes

Small businesses owners have consistently rated the estate tax issue as a high priority, their preference being that the estate tax be abolished. In both White House Conferences on Small Business, held in 1980 and 1986, estate tax issues were ranked very high among the list of concerns for small business owners from diverse industries, geographic areas, and among all income-producing categories.

Estate tax issues rank high in importance because to a small business owner, estate taxes too often have a direct and adverse effect on the owner's attempts to ensure the survival of the business. Continuation of a family-owned business after the owner's death compels a small business owner to be concerned with estate tax planning. The need for liquidity to protect the business translates into purchasing key man insurance and, to the extent possible, ensuring a line of succession in the business. This results in drains on capital reserves and hurts capital formation, consistently the biggest problem small firms face.

To a small business owner, whose primary concern is running his business, efforts to counteract the potential impact of estate taxes are counterproductive since they divert funds which could otherwise be used to buy more equipment or hire more employees, but which must now be used to buy life insurance and pay an estate tax consultant. In addition the small business owner sees the estate tax as the ultimate intrusion into his life: the small business owner's family is often intimately and inseparably involved in the business and is as responsible for its success as is the owner.

In 1985, estate and gift taxes accounted for less than 1% of the total collections of all taxes by the Internal Revenue Service, according to the Annual Report of the Commissioner and Chief Counsel of the IRS. In gross dollar terms, this represents collections of approximately $6.5 billion in 1985, an amount which has not varied much since 1980, when collections from estate taxes totalled a little more than $7 billion.

Clearly not much revenue is being collected from this tax, and no analysis has ever been made to determine its efficiency as a revenue-raising tool. The fact that less than 1% of all federal revenues are being raised by estate taxes should lead one to at least question the efficiency of the estate tax as a tool to raise significant amounts of revenues.

The estate tax issue is not a pitting of the rich vs. the poor. The distaste of the small business owner for estate tax issues is based on concerns for a portion of the tax code which wastes resources and compels the liquidation of the very family-owned businesses Congress so steadfastly claims it is trying to encourage.

Big dollars are not taxed under the estate taxes because wealthy families are protected by estate tax advisors who carefully plan transfers and trusts for these wealthy families.

Small businesses are always hurt the most by estate taxes. Small business owners typically do not engage estate planners for sophisticated planning. They prefer to put their resources and energies into their businesses with the hope of leaving them to their families.

What typically occurs, however, is that after the owner's death, the business -- which is usually the primary estate asset -- must be placed on the sales block, usually at distressed prices, to pay the estate taxes. Estate tax is not just a tax to small business owners; it is an insidious device which taxes their life's work at death.

The liquidity of small estates has been a key issue in every debate over changes in estate tax rules. Proponents of changes in the estate tax rules claim that increasing estate tax rates is equitable, but these proponents are not looking behind the rhetoric of the issue to determine who is really affected.

Among the options being considered by the Committee are estate tax rate increases and reductions in the unified credit, repeal of the stepped up basis rule, and imposition of an estate tax on the net value of an estate. None of these are acceptable options to the small business community.

The Economic Recovery Tax Act of 1981 had several provisions on estate taxes, most of which have finally become fully implemented just this year. Once again Congress would be changing the rules just as everyone becomes acclimated to them. In addition, the increases in estate tax rates would hurt small business, not large estates.

Federal Unemployment Tax Act (FUTA Provisions)

Two options cited by the Joint Committee on Taxation for raising revenues affect FUTA taxes: indexing the FUTA wage base, and extending the 0.2% FUTA surcharge which is due to expire this year.

Unemployment compensation tax rates are based on the employer's experience vis-a-vis his/her industry counterparts; this system of experience-based ratings is the cornerstone upon which the whole U.C. system is based. Taxes are deposited in state and federal funds to be used specifically for U.C benefit payments for workers.

The proposal for increasing the wage base would result in newly-generated revenues which technically could not be used for anything other than FUTA. This proposal both violates the longstanding concept of experience-based rates in the unemployment compensation system, and would not generate revenues which could be used to reduce the deficit. Therefore it is simply a payroll tax increase on employers which will only result in the creation of a big pool of money in the U.C. funds.

The second proposal under the FUTA section is a proposal for extending a surcharge imposed on FUTA tax rates. This proposal is similarly misguided. The surcharge on FUTA taxes was implemented in 1976 for a specific reason: to help states that had borrowed heavily during the high unemployment periods of the early 1980's pay off the debt owed the Treasury. As of October 1, the states will have paid off their debt to the federal government.

The surcharge was intended as a temporary tax to cover a specific problem. To extend the surtax now is a breach of faith with the employers of our nation. Never again will they accept a "temporary" tax for whatever purpose, because temporary can become permanent too easily when Congress is searching for additional revenues.

What is particularly disturbing about these two proposals is that payroll tax increases are the worst kind of tax increase Congress can impose because they increase the cost of labor directly, thereby reducing productivity and, in the short term, hurting job creation.

The membership of NFIB strongly opposes both of the FUTA provisions listed in the options list.

Additional Issues

In addition to the options we have already noted, the following options are also opposed by the small business community.

A Value Added Tax (VAT)

NFIB would be very concerned if, in the context of a budget reconciliation bill, Congress seriously considered imposing a Value Added Tax. In 1986, NFIB cosponsored a study of the impact of the VAT on small businesses in Europe. This study, entitled VAT and Small Business: European Experience and Implications for North America, contains a series of findings the Committee would find most enlighting.

Of the major findings of this study, one is most disturbing to NFIB:

> Both the business costs of complying with VAT and the government costs of administration are regressive with respect to size of firm. Measures typically taken to counteract this seem to be wholly or partially self-defeating. VAT and small business do not go well together.

In several Mandate polls on the issue of a consumption tax or a VAT, the NFIB membership consistently opposed a VAT or consumption tax when it was proposed as a tradeoff for some other tax. As a free standing new additional tax, there is no question about small business' strong opposition.

Imposition of a consumption tax or a VAT would have very broad consequences for our economy. It is not a decision which should be made in haste in the context of a budget reconciliation measure, and it certainly is ill advised before full implementation of the Tax Reform Act.

Health Issues

In 1986 NFIB surveyed its members on the top problems they face in running their businesses. This survey, known as the Problems and Priorities Survey, revealed that health insurance costs was their number one problem in 1986.

This is no great surprise, as the inflation rate in the health care field has been more than double that of the rest of the economy. These higher costs are rapidly translating into higher insurance premiums, and the spiral in health insurance costs continues upward.

Proposals to mandate increased coverages, by requiring catastrophic coverage for employees, implementing state risk pools, or similar ideas, are the wrong way to approach this issue. We would encourage this Committee not to take any actions in this area until a full examination of all health care issues has been accomplished.

Capital Gains Taxes

One of the more controversial decisions made in tax reform was to eliminate the preferential tax rate on capital gains and to treat income from the sale of capital assets as ordinary income.

Among the proposals listed in the JCT option book is a proposal for a reduction in the capital gains tax rate. As a result sales of capital assets would be taxed at a rate of 15% instead of the current rate of 28%. This rate change for capital gains would restore the preferential rate on capital gains which existed prior to enactment of tax reform.

Small business has traditionally favored a preferential tax rate on long-term capital gains to promote the benefits of long-term investment. Traditionally investors looking to promote small business have little in the way of incentives for making these investments. Investments are long term, with highly questionable liquidity, and the risk of no return or a total loss is fairly high. For these reasons the preferential rate on long term capital gains is believed to be a real inducement to invest in small firms.

Clear evidence exists in the form of studies performed by the Department of Treasury on the impact of previous reductions in the rate of capital gains. The results of the Steiger Amendment in the 1978 tax bill resulted in substantial revenue gains. There is no reason to believe that restoring the capital gains differential will not have a similar effect.

Ensuring adequate levels of capital for small business is an issue which needs to be considered. Tax reform eliminated many of the incentives for investment which previously existed. The emphasis of tax reform was to encourage investors to invest for income, not tax benefits. Small business investment would certainly be encouraged by reducing the tax rate on capital gains, and we would encourage the Committee to include such a reduction in its Reconciliation bill.

NFIB supports a capital gains preference because it is a pro-growth way to reduce the deficit. A capital gains tax cut will not only encourage investment in small business, it will also increase economic activity across a broad spectrum and raise revenues to further reduce the deficit. From NFIB's standpoint, it is much sounder economic policy to raise revenue by cutting capital gains taxes than by raising other taxes that would damper economic activity and eventually reduce total revenues.

0294T

Written Statement of the National Grange
Prepared by Mark C. Nestlen, Legislative Representative
Submitted to the House Ways and Means Committee
U.S. House of Representatives
July 15, 1987
re: Options to Raise Revenue in Order to Meet Reconciliation Instructions

Mr. Chairman, on behalf of the over 365,000 members of the National Grange, we appreciate the opportunity to submit for the record the Grange's view on a number of tax increase proposals. The statement will not be in order of importance to the Grange but for ease of reading, it will follow the sequence established in the Joint Committee print entitled "Description of Possible Options to Increase Revenues Prepared for the Committee on Ways and Means", published June 25, 1987.

It is the Grange's understanding that H. Con. Res. 93 requires the Committee on Ways and Means to report legislation which raises revenues by $19.3 billion in Fiscal Year (FY) 1988, $22.0 billion in FY89, and $23.0 billion in FY90, a total of $64.3 billion over the next three fiscal years. This increased revenue will assist in deficit reduction, an area of great concern to the members of the National Grange. We do, however, have some major concerns with a number of the options and we do support others. In the remainder of this statement, those areas will be highlighted.

EXCISE TAXES

* The National Grange supports the proposal to remove the 6 cents per gallon exemption for alcohol fuels. Those funds should not be used in the federal budget, they are dedicated funds to the Highway Trust Fund. We are strong supporters of the Highway Trust Fund and believe that this exemption benefits some highway users at the expense of others. It is true that the creation of alternate energy sources is important, however, there are ways to promote the production of gasohol blends that will not adversely affect the funds available for highway and bridge construction and repair. The Food Security Act of 1985 provided for such subsidization. The '85 Farm Bill allowed the Secretary of Agriculture to give free bushels of corn with purchased bushels. This helps to reduce the massive corn surplus and is a more equitable subsidy for the production of ethanol.

* The Grange strongly supports the efforts to repeal the windfall profits tax. Currently, the U.S. Government is not collecting any revenue under the windfall profits tax. Yet millions of dollars must be spent annually by oil companies in order to collect the data that is needed to fill out the tax forms that substantiate the fact that they owe little, if any taxes. It is projected that the repeal of the tax would have no revenue impact.

Even if oil prices rose from current levels, the windfall profits tax would be counterproductive to substantially increasing government tax revenues because as an excise tax on oil production that is designed to take as much as 70 cents of each dollar of additional oil industry revenue, the tax would substantially discourage the necessary investment in oil exploration and development that creates the revenues to pay the windfall profits tax; With the United States' dependence upon foreign sources of oil increasing and the U.S. oil industry facing economic dislocations due to lower worldwide oil prices, we consider it unwise to maintain government programs, such as the windfall profits tax, that artificially discourage the exploration for and production of U.S. domestic petroleum resources.

The fate of rural America is intertwined with the fate of our natural resources, such as oil. Energy costs are a large part of both the costs of production on our farms and the cost of living in rural areas. Energy exploration and development is a major employer in rural areas, just as those same areas bear a disproportionate burden of the economic and environmental risks of such development. The National Grange believes that national energy policy should not unduly interfere with the free market forces that best regulate the domestic demand for petroleum or the domestic oil industry's ability to meet that demand in an environmentally sound manner. The windfall profits tax is such an interference.

* The National Grange supports the increase in excise taxes for alcoholic beverages. We believe that the tax should be based on the alcohol content in the product. Alcoholic products are generally substitutes for one another, therefore the tax should be based on the equivalent value of alcohol contained.

* The Grange strongly opposes an increase in the excise tax on tobacco products. As recently as April 7, 1986, Congress permanently doubled the federal cigarette excise tax from 8 cents to 16 cents per pack. Doubling the tax to 32 cents will cause the loss of 28,500 American jobs in the core tobacco industry. (In 1982, when Congress temporarily increased the tax to 16 cents, 14,600 American job opportunities in the industry were lost.) Moreover, doubling the excise tax will cause harm to the American tobacco farmer, their families and communities. A 16-cent increase would result in an approximate decrease of $110 million in sales of leaf tobacco (27.4 million pounds), a result which will directly hit the farmer.

Tobacco is paying its fair share of taxes. In addition to the federal government, all 50 states and 388 city and municipal governments impose an excise tax on tobacco products. The average total tax on a pack of cigarettes is 37 cents (16 cents federal, 22 cents state and local). In addition to federal and state income taxes, over nine billion dollars was paid in excise taxes last year.

An increase in the excise tax on tobacco would be one of the most regressive of all tax increases considered. According to the Congressional Budget Office, as a percent of income, the increase would be more than 12 times higher for low-income (under $5,000) families than for high-income (over $50,000) families.

* Excise taxes in general are regressive in nature. With this in mind, we believe that an increase in telephone excise tax is poor public policy but an increase in the tax on luxury items (i.e. jewelry and furs) has merit. In the case of the telephone tax, low income families would pay more than 12 times as much as higher income families for a necessity. On the other hand, low income families normally do not buy luxury items, therefore the regressive nature of the tax is reduced.

* The National Grange strongly opposes the imposition of an oil import fee. Additionally we oppose an increase in the gasoline tax for any purpose other than to increase funds available in the Highway Trust Fund (at the present level of funding for highway programs, an increase is unnecessary at this time). Petroleum products are among the largest components of agricultural costs of production, both directly and indirectly. As petroleum prices escalated in the 1970's, farmers bore increased production costs. Now that petroleum is being priced in a more competitive market, farmers have the opportunity to narrow their cost price squeeze.

The Food Security Act of 1985 sent a clear message to farmers that lower commodity support prices and gradual decreases in target prices over the life of the Act means that U.S. farmers must eventually adjust their operations to efficiently derive more of their income from market sources. Implicit in that message, we believe, is a commitment by the federal government to our family farmers that if their farm products must be sold in a competitive free market, then the inputs they use to produce those products must also be priced by a competitive free market. Oil import fees and gas tax increases distort petroleum product prices upward even further and break the government's commitment to this nation's family farmers. On a 300 acre farm, a $10 a barrel oil import fee would raise the cost of production for wheat by $690, for corn by $1,080, for rice by $3,000, for soybeans by $660, and for cotton by $2,160.

As an essential commodity, gasoline is already heavily taxed. Based upon national averages, the total revenues to all levels of government from a 98.7 cents a gallon price for gasoline range from 27 cents to 37 cents. In addition to a 9 cents a gallon federal excise tax, the federal government also benefits from corporate income and corporate payroll taxes that are indirectly included in the price of each gallon of gasoline. Moreover, as gasoline prices decline, the taxes become a larger portion of consumer costs. Gasoline taxes have already risen 56 percent in this decade, and the federal tax jumped 125 percent in 1983.

In addition to farmers, residents of rural areas, especially those of the West, would bear a disproportionate share of the burden of a gasoline tax increase, and through that, a disproportionate share in reducing the federal deficit. Low income consumers would shoulder 48 percent more of the burden than middle and upper income families because the 1983 National Personal Transportation Survey by the U.S. Census Bureau indicates that nearly 78 percent of Americans who are earning less than $10,000 per year commute to work in private vehicles.

In non-urban areas, each household generates over 56 miles of auto travel daily as compared to about 40 miles of daily auto travel in large metropolitan areas with mass transit systems. Rural America will shoulder a 40 percent greater burden under a gasoline tax increase compared to residents of large cities who enjoy subsidized mass transit.

Western residents who rely upon gasoline to a greater extent than the national average will suffer under a gasoline tax increase. The per capita consumption of gasoline in Idaho is 467 gallons a year while New York's consumption is only 349 gallons. For Texas and Pennsylvania, the consumption is 581 gallons to 397. Higher per capita consumption means a higher burden under a gasoline tax. An increase in the motorfuel tax would force drivers in the South and West to contribute twice as much to deficit reduction as those in the North and the East. For example, based on average annual consumption, drivers in the District of Columbia would pay $47.30 for a 10-cent tax increase compared to $127.20 in Wyoming.

An oil import fee would have much the same disasterous effect on farm and rural communities as does a gasoline tax increase. Some proponents of an import fee believe that many communities would benefit from the increased economic activity that greater oil and natural gas exploration would generate. Oil exploration, however, is greatly affected by criteria that are not driven by price, such as environmental laws, land use regulations, and multiple use values on public lands. A simple oil fee that leaves other barriers to exploration firmly in place would not result in substantially increased exploration, or increased economic benefit to rural America.

Furthermore, economists cannot agree on the degree of benefit, even to the U.S. Treasury, of an oil import fee. At best, an oil import fee would be a short-term infusion of funds to the Treasury. Over the long run, competitively priced petroleum products reduce input costs, help to control inflation, improve international competitiveness, increase real economic growth and decrease unemployment. These side effects produce more benefit for the U.S. Treasury and the entire U.S. economy than policies of targeted price manipulation, such as a gasoline tax increase or an oil import fee.

* The National Grange strongly opposes the movement of any funds from the Highway Trust Fund or an increase in the taxes which fund the Trust for the purpose of any use other than the Trust Fund. The Grange believes the Fund provides a "user-fee oriented" mechanism for the construction and repair of highways, rural roads and bridges. The quality of America's infratructure is vital to the health of the agricultural economy.

GENERAL CONSUMPTION TAXES

* The National Grange opposes any type of a value added tax (VAT). This type of national sales tax would be regressive in nature and have a negative effect on agriculture. A VAT would increase the cost of production to agriculture producers and further tighten their cost-price squeeze.

INCOME TAX PROVISIONS

* The National Grange opposes any modification of the tax rates and/or brackets legislated in the Tax Reform Act of 1986 or a surtax on income tax liabilities. We have supported, and continue to support, a flat tax system. The results of the Act is the closest facsimile of a flat tax which is politically achievable at this time. Increasing the rates for certain brackets deviates from the flatest system achievable. Additionally, the lowered tax rates is the only reason that agriculture agreed to the loss of capital gains. If tax rates or brackets are modified, capital gains must be reinstated.

Moreover, an increase in tax rates will reduce savings, reduce employment opportunities and create other distortions due to the adverse effects on planned economic action. Further, an increase in rates or a surtax would break a pledge to taxpayers made by Congress when it passed the Act.

With respect to a temporary surtax, the Grange does not believe that this increase would be temporary but would be a permanent addition to the tax code, further distorting our desire for a flat tax.

For many of the same reasons stated above, the National Grange also opposes any changes in the rates made applicable to the Alternative Minimum Tax.

* A number of the proposals in the Joint Committee print, if enacted, could result in the decrease of charitable contributions by as much as $6.7 billion. The Grange opposes any further loss in the deductibility for donations to charitable organizations. (We vigorously opposed the loss of charitable contribution deductions for non-itemizers in last year's debate.) We are also concerned about the possibility of an excise tax of 5 percent imposed on tax-exempt organizations. We encourage this committee to consider these hidden results when enacting any of the revenue options.

* The Grange opposes the disallowance of deductions for nonbusiness personal property tax. In fact, the Grange opposed the loss of state sales tax deductions during the 1986 tax debate. The deduction disallowances would result in discrimination based on a taxpayers residence. Residents in states which impose only real property or income taxes would benefit at the expense of residents of states who have chosen to impose a personal property tax.

* The Grange supports controlling the abuse of cash method accounting by large corporations. Two options may help to achieve that goal. 1) Placing a cap on the use of cash accounting at a level high enough to allow traditional family farmers to continue its use but low enough to restrict the use of cash accounting by large corporations. 2) Eliminate the use of cash accounting if the taxpayer engages in related food processing activities.

* The National Grange worked hard to reduce the possibility of passive investment in agriculture during the Tax Reform Act of 1986. We supported passage of that legislation due to strong language eliminating such investment. The Department of the Treasury has also developed regulations which will severely restrict passive investment. We encourage Congress to recognize that unlike rental activities, farming is a labor intensive and capital intensive business. In the past few years, many producing farmers have required to take second jobs in order to survive on the farm during these depressed times. Treating rental activities and farming activities similarly does not recognize these differences.

* The National Grange supports lengthening the depreciation schedule to 15 years for single-purpose agriculture structures. During the '86 debate, House language called for 13 years, Senate language called for 10 years, and the Conference agreed to 7 years. We believe that 15 years is a more accurate reflection of the useful life of these structures. Any schedule less than 15 years simply encourages tax incentive production.

* The Grange opposes the repeal of the tax exempt status of credit unions. For the most part, credit union membership is limited, they are more directly controlled by their members, and they are generally limited to consumer loans which are safer and pay a lower interest rate. The tax exempt status allows the credit union to act more caustiously and in the interest of their members.

* The Grange opposes the proposal to repeal the oil and gas working interest provisions. Volatility of the oil market and the high level of risk involved in oil exporation makes it difficult for drillers to acquire capital without the special tax treatment. The provision contained in the Tax Reform Act of 1986 encourages oil exploration which reduces America's dependency on foreign energy sources.

VALUATION OF PROPERTY

* The National Grange strongly opposes any changes in the current estate and gift tax laws, particularly as they relate to agriculture. The Grange was very active in estate tax reform in 1976 and again in 1981. Significant and necessary relief was provided in 1981 and many of the options before this Committee today would eliminate the achievements made over the last 11 years.

It must be recognized that taxes are not necessarily levied for the sole purpose of financing government. Taxes can be a useful tool for implementing public policy and addressing public concerns. The Grange has worked in concert with other groups to establish as public policy the need to preserve and protect farmland for our future needs and to encourage family-sized farms and ranches to furnish food and fiber for domestic needs and international trade. The Grange is alarmed at the rate at which this country is losing its farmland and the decreasing number of families deriving their income from agriculture.

The concerns of our organization for the future of family agriculture involve the issues of resource conservation and farm structure, and both can be addressed through estate and gift taxation. Estate and gift taxation must be placed in the broader context of agricultural and land use policy. Simply stated, estate and gift taxes significantly affect farm structure. Changes obtained to allow agriculture to continue to be a feasible vocation for the sons and daughters of those in the agricultural industry must be retained. By facilitating the means by which farm estates can be passed on intact to heirs who desire to remain on the farm, efficient-sized agricultural operations will be assured for the future. Much of the decrease in the number of farm families can be attributed to the changes in agricultural production methods and technological improvements within agriculture. There are, however, limits to economies of scale, and farms should not be encouraged to expand beyond these limits. The Grange believes estate taxes are based on a sound premise and should not be modified at this time.

CONCLUSION

The National Grange realizes that the task ahead of the Ways and Means Committee is very difficult. As mentioned above, we support efforts to reduce the size of the federal deficit, however, many of the above-referred to options will have a damaging effect on American agriculture and rural America. However, we encourage you to review the areas which we believe can assist in deficit reduction and would be acceptable tax and public policy.

STATEMENT OF THE

NATIONAL REALTY COMMITTEE

This statement presents the views of the National Realty Committee ("NRC") respecting various options to increase Federal revenues contained in a pamphlet ("Description of Possible Options to Increase Revenues Prepared for the Committee on Ways and Means") (JCS-17-87) issued by the Staff of the Joint Committee on Taxation with the Staff of the Committee on Ways and Means on June 25, 1987. The NRC is a non-profit business league which represents a significant and diverse cross-section of the rental real estate industry and which is concerned with the overall health and growth of that industry. NRC members include owners, developers, and operators of all types of real estate throughout the United States.

NRC contends that certain of the options ("Revenue Options") contained in JCS-17-87 would, if instituted, have a severe and adverse impact on the American real estate industry, an industry which is already reeling from the impact of the various provisions of the Tax Reform Act of 1986.

The purpose of this statement is to call to the Committee's attention some particularly detrimental proposals contained within the Revenue Options, so that the Committee can focus on the deleterious impact of the same on the real estate industry.

The principal concerns on which we urge the Committee to focus are as follows:

(1) Installment Sales -- Income Tax Revenue Option 6h

This Revenue Option lists two possible proposals. The first is repeal of the installment method for all dealer sales and all non-dealer sales to which the proportionate disallowance rule under the 1986 Tax Reform Act apply. The second is repeal of the installment method for all dealer sales and charging interest to non-dealers who use the installment method of reporting.

When considering any change to the tax treatment of installment sales it is worth asking why, historically, the installment method of reporting was placed into the Internal Revenue Code. For this purpose, a particularly good source is the overview of the Installment Sales Revision Act of 1980 contained in the Senate Finance Committee Report, where it was stated that: "The function of the installment method of reporting income is to permit the spreading of income tax over the period during which payments of the sales price are received. Thus, the installment method alleviates possible liquidity problems which might arise from the bunching of gain in the year of sale when a portion of the selling price has not been actually received."

The purpose of the Installment Sales Revision Act of 1980 was to simplify the use of the installment method of reporting. The Tax Reform Act of 1986, in turn, created significant complexity in the use of installment method of reporting. As may be recalled, the initial thrust of the Tax Reform Act of 1986 was to tax so-called "builder bonds" that were recognized to be thinly-disguised dispositions of installment obligations. That initial thrust by the House of Representatives was later displaced by a wholesale rending of the entire fabric of the installment method, leaving, as some have said, "one of the most complex sets of rules found in the Code."

Rather than tax persons who have not yet received sales proceeds (except on the disposition of the installment obligation), and rather than charge interest for the privilege of using the installment method (inasmuch as income tax is being charged on the interest paid, accrued or imputed as a result of the deferral of collection), an attempt should be made to return to the simplicity of approach contained in pre-1987 law for installment sales of real property by non-dealers.

(2) Partnership Provisions -- Income Tax Revenue Option 10

This Revenue Option contains a number of proposals which, quite clearly, reverse the entire history of Federal income taxation. For some reason, the proposals in Revenue Option 10 seem to be based on the underlying assumption that a partnership is "evil" *per se*. It is granted that some unacceptable "tax shelter" schemes in the past have used the partnership form; however, a review of the cases and Revenue Service rulings easily reveals that corporations (both widely-held and closely-held), trusts and individuals have all likewise taken part in such "tax shelter" schemes, particularly at a time when there were no substantial statutory or judicial restraints upon the same. It does not appear to be fair and equitable, in the overall perspective of Federal income taxation, to single out the partnership, as if it were an undesirable element in our society, to be ostracized, punished and penalized at every turn.

First, focus should be placed upon Revenue Option 10a, containing proposals relating to master limited partnerships (or "publicly traded" or "publicly offered" limited partnerships). These entities are far more inclusive than might be imagined on first blush. A "publicly offered" limited partnership is, under many interpretations, one subject to Federal or state securities laws, inasmuch as a limited partnership interest may be, in and of itself, a security. This means that, although there may be exemptions which eliminate the need for registration with the Securities and Exchange Commission or the appropriate State Securities Commissioner, such a limited partnership interest is "publicly offered".

Furthermore, the proposal not to allow any pass-through of any losses or deductions from a partnership, as is set forth in Revenue Option 10a (as to master limited partnerships) and Revenue Option 10d (as to all limited partnerships), is inherently a reversal of all prior tax history. In addition, Revenue Option 10d has an unfortunate exclusionary tinge to it. The great bulk of the investors in the United States is comprised of middle-income investors, however great the group of "middle-income" investors may be defined. These persons prudently desire to limit their potential liability and risk of loss from investments; accordingly, limited partner status is often essential to their participation in the real estate marketplace. These investors can participate in the real estate arena as limited partners because the Uniform Limited Partnership Acts, and particularly the Revised Uniform Limited Partnership Acts, throughout the States, have kept up with the times, affording them greater protections without increasing their potential liability to partnership creditors. To penalize those owners of rental real estate who choose to be limited partners for valid, non-tax-motivated reasons is unfair, inequitable, and extreme.

(3) Alternative Minimum Tax -- Income Tax Revenue Option 15

In one of the Alternative Minimum Tax Revenue Options (15(3)), it is proposed to add a preference to the alternative minimum tax "provisions providing for non-recognition of gain". It should be recalled that, historically, the provisions as to non-recognition of gain were placed into the Internal Revenue Code because they reflected the understanding of Congress that a person should not be taxed on a continuity of investment. Thus, a corporate reorganization under Sections 351-368 of the Internal Revenue Code, such as the exchange of stock of one corporation solely for voting stock of another corporation (under Section 368(a)(1)(B) of the Code) reflects a continuity of investment by the exchanging stockholder, which it was deemed should not be taxed.

The trade of real estate for real estate of a "like kind", which is real estate to be "held for productive use in a trade or business or for investment", was not subject to income recognition because it constituted a continuity of investment. This is not a means of tax avoidance or evasion, because the adjusted basis of the taxpayer in the real estate given up is carried over to, and becomes the adjusted basis of, the taxpayer in the real estate acquired. Therefore, the full amount of the gain is recognized on a later sale or disposition of the property.

To impose an alternative minimum tax (at a rate of 21 percent or more (Income Tax Revenue Option 15(1)) on an event which does not otherwise result in recognition of income tax (which, in any event, starting in 1988 would only be 28 percent (disregarding Income Tax Revenue Option 1)) is a radical departure from prior practice, and truly inequitable.

Likewise, Congress decided in the Tax Reform Act of 1986 that, in the case of C corporations which were closely held (based on traditional personal holding company stock ownership tests), the passive loss limitations under the 1986 Act could serve to prohibit such corporations from offsetting portfolio income with passive losses. However, neither closely-held C corporations nor widely-held C corporations would be prohibited from offsetting active income with passive losses. This absence of prohibition accords with the traditional income tax theory as to C corporations (other than personal holding corporations) that all of their activities are considered business-related activities, undertaken in one form or another to enhance their ultimate profitability and value to their shareholders.

The proposal contained in Income Tax Revenue Option 15(4) to impose the passive loss limitations on all corporations would be a major departure from the concept of the C corporation as a business, with a profit orientation. Furthermore, from the standpoint of NRC the proposal looks like a mad wolf in a sheep's rent clothing. Inasmuch as a C corporation is not a pass-through entity, who would be the focus of "activity" by the corporation? Which officer or officers would reflect "regular, continuous and substantial" corporate activity? It is not far-fetched to believe that, in fact, the real objective of this proposal is to keep C corporations from participating in rental real estate as well as other rental activities, the only activities which are passive _per se_ under the current passive loss rules.

(4) _Like-Kind Exchanges_ -- _Income Tax Revenue Option 14_

This Revenue Option proposes to expand the types of property that cannot be treated as like-kind property to include all real estate. An alternative thereto is to replace the like-kind standard, which focuses on "property held for productive use in a trade or business or for investment", with the standard for reinvestment or condemnation or other involuntary conversions, which is that Congress would permit such recognition only for property "similar or related in service or use".

In 1958, because of difficulties in interpreting the concept of "similar or related in service or use", Congress, with regard to involuntary conversions, broadened the scope of the statute relating to real estate in order to permit the reinvestment of proceeds from an involuntary conversion into property held for productive use in a trade or business or for investment. That broadening took place because the standard of "similar or related in service or use" was very restrictive and created problems of interpretation. The proposal contained in Revenue Option 14 to use the involuntary conversion standard would once again bring back the same thorny problems.

Moreover, the proposal to eliminate real estate as an item as to which like-kind non-recognition status is granted is clearly discriminatory. Why only real estate? Rhetorically speaking, why not simply eliminate the like-kind provision as to all property if you are going to broaden that provision at all?

It should be recalled that the items as to which there is not any non-recognition, under Section 1031(a)(2) of the Code, are those items -- such as stock or securities, promissory notes and choses in actions -- which are either readily tradeable or relatively liquid at all times. Real estate is neither readily tradeable nor relatively liquid, as is clearly recognized in other provisions of the Code.

(5) Stepped-Up Basis -- Gift and Estate Tax Revenue Option 2

Revenue Option 2 essentially contains two alternatives. The first is to impose the taxation of capital gains on death, because there is a step-up of basis on death. As an alternative, it is proposed that there not be step-up of basis on death, but only a carryover of basis.

NRC notes that the carryover of basis concept was attempted under the Tax Reform Act of 1976 and, ultimately, was repealed retroactively to the date on which it was to be effective because of the understanding by Congress at that time that there was no benefit in doing so, and no easy methodology for accomplishing the same.

The taxation of "gain" at death, particularly "gain" due wholly to inflation, is a radical departure from the history of the Federal estate and gift tax laws. First, it would have a material and adverse impact on less-wealthy taxpayers who have less significant estates (in many cases, comprised only of their homes, plus, in some instances, stocks, securities and perhaps a real estate or business interest) and who have worked very hard all of their lives to be able to build something up to pass on to their heirs, without the Federal government taking a significant share thereof. Second, wealthier taxpayers whose businesses or assets consist of primarily illiquid investments would come under tremendous tax-motivated pressure to dispose of their businesses or assets prior to death. Otherwise, their heirs would be forced to disassemble the family business or portfolio to pay taxes after the death of the owner. It should be remembered that death is not a voluntary action, resulting in a voluntary disposition by the decedent of his or her property.

(6) Estate Freezes and Minority Discounts --
Gift and Estate Tax Revenue Option 4

For NRC, a genuine surprise. It is indeed strange to see proposals that an estate freeze and a minority discount not be permitted in the valuation of property. The estate freeze and the minority discount are reflective of judicial recognition that a person can, by making a gift or a transfer of an interest in property, freeze the value of his or her remaining property in order to reduce the size of his or her estate. This is reflective of the fact that there are, with traditional estate planning concepts, valid, viable and completely above-board techniques for reducing taxable estates. These are not avoidance or evasion techniques, and they are, and have traditionally been, clearly acceptable, even in this era of judicial or legislative defeat for all evasion and avoidance techniques.

In addition, the courts have recognized that minority interests in property simply are not worth as much as controlling interests, because they do not reflect the ability to exercise control over the entity. To seek to eliminate the freeze and the minority discount as a means of raising revenue is to say that a person who has property should be disadvantaged simply because of the same. Philosophically, that runs directly contrary to the United States Constitution.

(7) Depreciation -- Income Tax Revenue Option 11a

Under this Revenue Option, the recovery period of property would be determined by reference to 125 percent of a lease (including extensions) or other contract terms. Again, it appears that the real estate industry is being made a scapegoat for purposes of revenue raising. NRC cannot understand why the lease term is relevant to the life of the property, particularly after the Tax Reform Act of 1986. Rather, the long recovery lives for real property -- which are currently 27 1/2 years for residential property, 31 1/2 years for non-residential property, and 40 years under the minimum tax -- seem to be quite extended already.

The mere existence of a lease or other contract does not eliminate the fact that property does deteriorate, and that depreciation is allowed as a deduction in order to take into account wear and tear, decay and anticipated obsolescence. If a lease, by its terms, removes the burdens and risk of loss of property from a taxpayer, then that taxpayer is not entitled to any depreciation deduction. However, unless it is intended to "penalize" the taxpayer by reason of having entered a long-term lease (as is the situation, at present, with respect to tax-exempt entity leasing, under Section 168(g)(3) of the Code), this Revenue Option should not be acceptable.

(8) Equity Kickers -- Tax-Exempt Organization Revenue Option 3

This Revenue Option would impose an unrelated business income tax on "equity kickers" on "loans to business ventures". It must be understood, however, that such "equity kickers" are simply a means for a tax-exempt organization to achieve an acceptable rate of return on its loan. This does not mean that the loan is an investment. Rather, because of periods of rampant and unpredictable inflation in the past, tax-exempt organizations, and indeed taxable lenders, focused on the equity kicker as a means of protection against inflation which assures the lender that the value of its loan principal will keep pace with the economy. This Revenue Option is an attempt to focus on an erroneous assumption -- that is, that an equity kicker inherently makes a loan into an investment. That simply is not true.

In all events, recognizing that there were recently Ways and Means Subcommittee hearings as to unrelated business taxable income of tax-exempt organizations, it would appear that those hearings would best be utilized to focus on any changes in unrelated business taxable income.

(9) Corporate Provisions -- Income Tax Revenue Option 9

The proposals contained in Revenue Option 9 in large measure again raise the issue as to whether there should be single (or integrated) taxation of a corporation and its shareholders or double taxation.

The elimination of the present intercorporate dividends received deduction, or any significant modification thereof, as set forth in Revenue Option 9a, could move from double taxation (that is, taxation of the corporation earning the income and taxation of the ultimate recipient) to triple taxation (that is, taxation of the corporation earning the income, taxation of the corporation receiving the dividend and taxation of the ultimate recipient -- the shareholder of the corporation receiving the dividend). This would be yet another factor adding to comparative tax rate disequilibrium, thereby further driving corporations toward disincorporation.

With regard to debt financing, as reflected in Revenue Option 9d, it should be pointed out that the Treasury Department has, in attempting to distinguish debt from equity as a result of the enactment of Section 385 of the Code in the Tax Reform Act of 1976, come to the recognition that what may be debt in one situation simply cannot be called debt in another situation. Small business is quite different from big business; service business is different from manufacturing; and real estate is different from other natural resources. Any provisions which attempt to deal with this concept must recognize that there are different kinds of entities and different kinds of assets which are effected. Revenue Option 9d decidedly does not do sc.

The proposals as to "tax benefit mergers" in Revenue Option 9f seem to imply that corporate losses are, again, a means of achieving "tax shelter". It must be pointed out that corporate losses are derived from business operations. If there is no means of utilizing those losses against future income, then risk-taking, which has traditionally been a characteristic of the American business, resulting in the growth of the economy, would be totally undesirable and further constricted. As a matter of policy, the income tax laws should encourage, not discourage, risk-taking, if the United States is to remain viable in the current world economy. Corporations must be able to utilize present losses against future or other income in order to be able to sustain their growth and futures.

(10) Excise Tax on Net Investment Income -- Tax-Exempt Organization Revenue Option 2

This Revenue Option would impose an excise tax of 5 percent on the net investment income of all tax-exempt organizations, including charitable, educational, religious and scientific organizations. This is purely a revenue enhancer, at the direct expense of those organizations which serve the public welfare. These organizations have already been hurt by the diminution in value of the charitable contribution deduction. Assuming that it is recognized that these organizations serve to remove a burden from government, why are they to be penalized?

In conclusion, NRC hopes that the Committee will reflect upon the fact that the Internal Revenue Code, because it has had so many changes over the past several years, is easily misunderstood, even by those who have the wealth and resources to hire a multitude of tax attorneys and accountants to interpret the provisions. At this point, there is no reason to tinker further with the income tax provisions of the Internal Revenue Code. Stability should be the order of the day, so that the multitude of perplexing changes over the past few years can be assimilated.

Respectfully submitted,

NATIONAL REALTY COMMITTEE, INC.

By E. Wayne Thevenot

E. Wayne Thevenot, President

Save the dates...
NRMA's 77th ANNUAL CONVENTION & EXPOSITION
Sunday, January 10th—Wednesday January 13th, 1988
The New York Hilton & Sheraton Centre Hotels

National Retail Merchants Association

nrma

TELEX—INT'L 220 - 883 - TAUR
TWS—DOMESTIC 710 - 581 - 5380 TPNYK
ATTN: NRMA

1000 Connecticut Avenue, N.W.
Washington, D.C. 20036
202/223-8250

July 24, 1987

The Honorable Dan Rostenkowski
Chairman
Committee on Ways and Means
United States House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Chairman:

I am writing on behalf of the National Retail Merchants Association ("NRMA") to express our opposition to certain of the revenue raising options contained in a pamphlet[1] prepared by the staff of the Joint Committee on Taxation in conjunction with the staff of the House Committee on Ways and Means.

By way of background, NRMA is the nation's largest trade association for the general merchandise retail industry. Our members operate 45,000 leading department, chain, independent and specialty stores in all 50 states. Annual sales of our members exceed $150 billion and we employ more than three million workers.

NRMA was an early supporter of the income tax reform movement, advocating the reduced rates and base broadening provisions contained in President Reagan's comprehensive tax reform proposal. NRMA strongly supported the fundamental restructuring of the corporate and individual income tax laws that was ultimately embodied in the Tax Reform Act of 1986 (the "1986 Act"), in spite of the fact that many retailers

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[1] Joint Committee on Taxation, Description of Possible Options to Increase Revenues Prepared for the Committee on Ways and Means (JCS-17-87), June 25, 1987. All page references are to such pamphlet.

EXECUTIVE OFFICERS

Chairman of the Board
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New York, New York

President
JAMES R. WILLIAMS
NRMA
100 West 31st Street
New York, New York

Home Office: 100 West 31st Street, New York, N.Y. 10001

were severely hurt by certain provisions of the 1986 Act legislation, particularly the disallowance of the use of the installment method for revolving credit sales and the expansion of the uniform capitalization rules. The impact on retailers of these and other 1986 Act amendments is staggering. Contrary to the misperception that retailers benefitted from the 1986 Act because of rate reduction, the overall impact of the legislation was generally detrimental to the industry. Many major retailers will require approximately seven years before the cumulative tax burden under the 1986 Act falls to the level which such retailers would have paid under prior law. Not only does this impact our larger retailers but many of our smaller and mid-size retailers have indicated that they also do not expect to see any benefit from the 1986 Act for some time.

NRMA believes that a number of the revenue raising options contained in the Joint Committee pamphlet would be a step backwards from the achievements of the 1986 Act and would be inconsistent with the fundamental goals of tax reform. With the exception of the comment concerning tax rates and surtaxes, which we view as of primary importance, the order in which these comments discuss particular revenue options is not intended to reflect the relative priority of each of the options to NRMA.

1. Individual and Corporate Tax Rates and Surtaxes (p. 84). The pamphlet sets forth a number of proposals relating to the individual and corporate tax rates including (a) the imposition of a 5% surtax on individual and corporate income tax liabilities, (b) an extension of the 1987 tax rate schedules for both individuals and corporations and (c) the creation of a third and/or fourth marginal tax bracket. NRMA opposes these revenue raising measures because they would have an adverse effect on the U.S. economy and would be inconsistent with a pledge made to taxpayers upon enactment of the base broadening provisions of the 1986 Act.

From the perspective of the retail industry, the most critical feature of the 1986 Act was the reduction of the maximum corporate tax rate. The retail industry traditionally has paid taxes at high effective tax rates and we believe that part of the unfairness inherent in the old tax system could be alleviated only by maintaining the significant reduction in the maximum corporate tax rate contained in the 1986 Act.

An increase in the individual tax rates would lead to a reduction in consumer spending that would have an adverse impact on the economy. Furthermore, an increase in the tax rates of higher income individuals would be unfair because many of these individuals incurred the greatest increase in individual tax burdens under the base-broadening provisions of the 1986 Act. Much of the support for these base-broadening provisions was contingent on the lower tax rates included in the 1986 Act because retailers believed that the tax rate cuts would stimulate the economy and provide for greater equity among taxpayers.

Accordingly, NRMA advocates the retention of the 1986 Act tax rate cuts without the imposition of a surtax or the postponement of the effective date of the 1988 tax rate cut.

2. Limitations on Deductibility of Advertising Costs (p. 138). The pamphlet proposes that all or a specified portion of advertising costs paid or incurred during a taxable year be amortized over some period of time, rather than deducted currently. NRMA is opposed to such a proposal on the grounds that advertising costs are actually costs of selling products in the current taxable year and do not create a separate and distinct asset having a life that extends substantially beyond the taxable year. A severe administrative burden would result if it were necessary to differentiate between amortizable advertising expenses on the one hand and fully deductible selling expenses on the other hand. Furthermore, it is impossible to verify the degree or proper allocation of any benefit of advertising for future years.

3. Repeal of the LIFO Method of Inventory Accounting (p. 130). An additional revenue-raising proposal is the repeal of the LIFO method of inventory accounting. NRMA strongly opposes such repeal because the LIFO method is the most accurate measure of income during periods of inflation. The LIFO method is also an acceptable method of accounting for financial statement purposes.

4. PBGC Premiums (p. 24). The pamphlet proposes an increase in the base premium rate paid with respect to Pension Benefit Guaranty Corporation ("PBGC") plan termination insurance from the present $8.50 per plan participant to $14 per plan participant. In addition, higher premiums would be charged to those employers who do not adequately fund their pension plans.

NRMA supports the concept of a variable rate PBGC premium structure under which greater premiums would be imposed on those employers whose defined benefit plans represent the greatest risk of potential loss to the PBGC. However, NRMA opposes the increase in the base premium rate so as not to undermine the benefit security objectives of ERISA. Substantial increases in the base rate would encourage employers to terminate their defined benefit pension plans because their costs would be increased with no corresponding increase in benefits (i.e., PBGC guarantees) received. An increase in terminations could, in turn, increase PBGC's potential risk by reducing the PBGC premium base and removing from the base those plans which present the least risk.

5. Federal Unemployment Tax Act (FUTA) Provisions (p. 76). NRMA opposes the indexing of the FUTA wage base and the extension of the temporary 0.2 percent component of the gross FUTA tax rate set to expire after 1987. The FUTA wage base and tax rate should only be adjusted in response to specific needs relating to unemployment compensation, rather than in response to a general concern for revenue. Furthermore, the reduction in the FUTA tax rate scheduled after 1987 will encourage the employment of low-income workers and will offset the increase in employer social security taxes scheduled after 1988.

6. Excise Taxes (p. 35). NRMA believes that an increase in existing excise taxes or the imposition of additional excise taxes would counter the benefits of the 1986 Act income tax rate cut to lower and middle income taxpayers. Excise taxes are regressive -- i.e., they cost such taxpayers a larger percentage of disposable income than they cost wealthier individuals making the same purchases.

7. Consumption Taxes (p. 79). (a) Value-Added Tax. NRMA opposes the use of a broad-based value-added tax ("VAT") as a revenue raising option. Under the Joint Committee proposal, a VAT would be levied on the sale of manufactured goods at each stage of the production process and on most imported products.

The burden of a VAT would ultimately be transferred to consumers and, accordingly, would be factored into the selling price of the product. This hidden tax, which would be reflected in higher prices to consumers, would fall disproportionately on lower and middle income taxpayers.

(b) Business Alternative Minimum Tax. NRMA also opposes the imposition of a "business alternative minimum tax" ("BAMT") which would tax net business receipts (i.e. the excess of any business receipts over business expenses) and imports. The BAMT does not, however, operate as a conventional minimum tax because tax liability is unrelated to profitability. Accordingly, a retailer with losses could have substantial BAMT liability if its business receipts exceed its business expenses. Furthermore, such a tax would also be passed on to consumers and would result in higher prices, further disabling the economy.

* * * *

NRMA believes that the 1986 Act as a whole should be left alone and allowed to run its course. Changes to the Internal Revenue Code at the present time would prevent the achievement of the 1986 Act's objectives.

If there is a need to raise additional revenue to meet budget requirements, such revenue should be raised in a manner that observes the fundamental principles of tax equity and fairness. The revenue raising options discussed in this letter are unfair and inequitable and, accordingly, NRMA urges you to oppose such taxes. This letter covers only a few of the revenue raising options set out in the pamphlet. However, there are a number of other items in the pamphlet that concern NRMA. Accordingly, we would like the opportunity to sit down with you and your staff to conduct a more comprehensive discussion of the various revenue-raising options.

Sincerely,

Tracy Mullin

Tracy Mullin
Senior Vice President
Government Affairs

OFFICE PHONE
646-2871

Everette Nelms
P.O. BOX 8
MONTGOMERY, LA. 71454
Land and Timber Management

RESIDENCE PHONE
646-3309

July 15,1987.

Honorable Dan Rostamkowski
Chairman House Ways and Means Com.,
House of Representatives.
Washington, D. C. #

Dear Sir:-

I sincerely hope you have fully recovered from your recent operation and that no complication sets in.

As a Southner Demoncrat I believe in and pratice fiscal responsibility.In other words do not spend more than you expect to take in.

I have been seeing in the news media about new taxes being propose-most are called "sin" taxes and the others "soak" the other fellow,especially if the other fellow was rumored to have more than you have.

Taxes are suppose to raise revenue-not to "soak" someone esle.

There are two sources of additional reveune-tax do not allow state and local income taxes as a deduction they are not a cost item of production as property and sales taxes.

Another source would be a tax on non-alcoholic,carbonated beverages of .05¢ per container of one liter or less, .10¢ per container over one liter-tax to be collected at the bottling plant.It may or may not be past on to the comsumer.Millions can be raised from this tax-just go into a super market and see how many ~~differe~~ different brands are on the selves. We had this tax W.W.I

While not charges $1.00 on each book of food stamps as a handling charge -the stamps would be free-but millions would be saved.The recipient would not be injured by this charge.

I, for one, would like to ~~thak~~ thank you for steering the present tax bill though congress-it was believed dead until you took over and guided it through congress and as you said, lets give it a trial.

Very truly yours,

Everette Nelms

Potomac Electric Power Company
1900 Pennsylvania Ave., N. W.
Washington, D. C. 20068
(202) 872-2365

ALAN G. KIRK II
SENIOR VICE PRESIDENT
GENERAL COUNSEL
SECRETARY

September 10, 1987

Honorable Dan Rostenkowski
Chairman
Committee on Ways and Means
1102 Longworth House Office Building
Washington, DC 20515

Dear Congressman Rostenkowski:

The recently passed Concurrent Budget Resolution for FY 1988 calls for a $64.3 billion revenue increase over three years in order to help meet the Graham-Rudman-Hollings deficit reduction targets. In order to determine how to raise these revenues, a report was prepared entitled, Description of Possible Options to Increase Revenues Prepared for the Committee on Ways and Means. I am writing on behalf of Potomac Electric Power Company to oppose Option 9-A of the report. I also am writing to let you know of PEPCO's opposition to any option to increase revenues which is based upon broad-based energy taxes or pollution excise taxes or which would make any substantive changes to the Tax Reform Act of 1986. In this regard, my company fully supports the statement of the Edison Electric Institute which was submitted to you on July 14th of this year, a copy of which is enclosed.

Option 9-A would cut back or cut out the "intercorporate dividends received deduction," whereby U.S. corporate investors are permitted to exclude from federal income tax eighty percent of the dividend income they receive from other U.S. corporations. The removal or curtailment of this deduction would have an adverse impact on the market for PEPCO's preferred and common stock. For example, PEPCO now has outstanding a preferred stock issue totaling 350,000 shares that was issued solely to corporate investors. This option would significantly lessen the attractiveness of such issues to corporate investors and would, thereby, increase both our cost of raising capital and, ultimately, the cost of electricity to our customers.

I appreciate the opportunity to offer my company's position opposing the adoption of these proposals.

Sincerely,

Enclosure

(SEE STATEMENT OF EDISON ELECTRIC INSTITUTE ELSEWHERE IN THIS VOLUME.)

Small
Business
Legislative
Council®

July 17, 1987

Honorable Dan Rostenkowski, Chairman
United States Senate
Committee on Ways and Means
1102 Longworth House Office Building
Washington, DC 20515

Dear Mr. Chairman:

On behalf of the Small Business Legislative Council (SBLC), I wish to submit the following comments regarding the options to increase revenue to meet the targets of the fiscal year 1988 Budget Resolution.

The Small Business Legislative Council (SBLC) is a permanent, independent coalition of ninety trade associations representing over four million small businesses. Our sole mission is to represent the interests of small business in national policy matters. A list of our members is attached.

First, our organization is adamantly opposed to the use of increased revenues to meet the target of the budget resolution. It has been our position such targets should be met through spending reductions.

In recent weeks you have heard from many specific industries that have explained in great detail the impact of certain revenue options on their industries. As an organization representing manufacturing, distribution, retailing, construction, agriculture and professional and technical services let me also share with you a slightly different concern.

As an organization we opposed the Tax Reform Act of 1986. Some of our member groups fared better than others, but on the whole, it was our conclusion that small business, not withstanding the lower personal rates, benefitted the least from the legislation. An SBA study issued prior to passage indicated such would be the case, and so far informal polls by our member associations conducted after passage bear this out.

The point of this discussion is that many of the options before you hit small businesses particularly hard. Whether they are excise taxes on such items as fuel or jewelry, changes in estate tax rules or limitations on deductions for advertising, to name just a few, the list of options heralds bad news for small business.

We ask that you apply a critical litmus test to these options: What is the impact on small business? It is vitally important that Congress and the Department of Treasury use the data only you possess, to identify clearly the impact on small business.

It remains critically important we keep small business on a path of growth and job creation.

Sincerely,

John S. Satagaj
President

Members of the Small Business Legislative Council

Alliance of Independent Store Owners and Professionals
American Association of Nurserymen
American Consulting Engineers Council
American Council of Independent Laboratories
American Dental Trade Association
American Electronics Association
American Machine Tool Distributors Association
American Society of Travel Agents, Inc.
American Sod Producers Association
American Subcontractors Association
American Textile Machinery Association
American Trucking Associations, Inc.
American Warehousemen's Association
Architectural Precast Association
Associated Landscape Contractors of America
Association of Physical Fitness Centers
Association of Small Business Development Centers
Association of the Wall and Ceiling Industries-International
Automotive Service Association
Automotive Warehouse Distributors Association
Building Service Contractors Association International
Business Advertising Council
Christian Booksellers Association
Direct Selling Association
Electronic Representatives Association
Florists' Transworld Delivery Association
Helicopter Association International
Independent Bakers Association
Independent Bankers Association of America
Independent Insurance Agents of America, Inc.
Independent Medical Distributors Association
Independent Sewing Machine Dealers Association
International Association of Refrigerated Warehouses
International Bottled Water Association
International Communications Industries Association
International Fence Industry Association
International Franchise Association

International Reciprocal Trade Association
Jewelers of America
Latin American Manufacturers Association
Machinery Dealers National Association
Manufacturers Agents National Association
Mechanical Contractors Association of America, Inc.
Menswear Retailers of America
National Association for the Self-Employed
National Association of Aircraft and Communication Suppliers
National Association of Brick Distributors
National Association of Catalog Showroom Merchandisers
National Association of Chemical Distributors
National Association of Development Companies
National Association of Home Builders
National Association of Investment Companies
National Association of Manufacturing Opticians
National Association of Personnel Consultants
National Association of Plumbing-Heating-Cooling Contractors
National Association of Realtors
National Association of Retail Druggists
National Association of Small Business Investment Companies
National Association of the Remodeling Industry
National Association of Truck Stop Operators
National Association of Women Business Owners
National Candy Wholesalers Association
National Chimney Sweep Guild
National Coffee Service Association
National Council for Industrial Innovation
National Electrical Contractors Association
National Fastener Distributors Association
National Grocers Association
National Independent Dairy-Foods Association
National Moving and Storage Association
National Office Products Association
National Parking Association
National Precast Concrete Association
National Shoe Retailers Association
National Society of Public Accountants
National Tire Dealers & Retreaders Association
National Tooling and Machining Association
National Tour Association
National Venture Capital Association
Opticians Association of America
Petroleum Marketers Association
Printing Industries of America, Inc.
Retail Floorcovering Institute
Small Business Council of America, Inc.
Smaller Manufacturers Council
Society of American Florists
Specialty Advertising Association International
United Bus Owners of America
Web Sling Association

STATEMENT OF THE
SOCIETY OF INDEPENDENT GASOLINE MARKETERS OF AMERICA
CONCERNING PROPOSALS TO RAISE REVENUE

The Society of Independent Gasoline Marketers of America ("SIGMA") is a national trade association comprised of approximately 300 independent marketers and chain retailers of motor fuels. SIGMA's members market refined petroleum products in all 50 states and account for approximately 20 percent of the United States retail market for motor gasoiline.

Independent marketers, such as SIGMA's members, have had a beneficial impact on price competition in the retail gasoline marketplace. They have introduced such marketing devices as self service, high volume/low margin marketing, and automated retail marketing. In fact, private brand marketers historically have been recognized as the most price-competitive segment of the retail gasoline market.

They neither produce nor refine crude oil. Thus, they are entirely dependent upon third parties for their sources of supply. Moreover, SIGMA's members compete directly at the retail level with companies from which they obtain supplies of product at wholesale. Our ability to price competitively derives from our functional efficiencies. SIGMA's members innovative marketing concepts and systems of cost control have minimized the amount of fixed costs which must be recovered in the per unit price of motor fuels. Such efficiencies can generate a cost advantage of as much as one or one-and-one half cents per gallon. However, this cost advantage is relevant in the marketplace only when SIGMA's members can obtain competitively-priced supplies at the wholesale level. Absent the availability of such competitively-priced products, the efficiencies and innovations of independent marketers would be rendered irrelevant in the market and independent marketers could not survive.

SIGMA has traditionally opposed government intervention in the gasoline industry during periods of adequate supply. Government intervention interferes with the competitive efficiencies which independent marketers have developed. Government interference which disrupts the competitive market structure for distribution of motor fuels can cause misallocation of fuel supplies and spot shortages. Such interference often reduces competition by providing special advantages to one segment of the distribution system. These comments reflect SIGMA's opposition to legislative proposals that would make the wholesale and retail gasoline markets less competitive. SIGMA supports measures that would create more competition through greater access to competitively priced supplies of motor fuels.

I. SIGMA SUPPORTS REPEAL OF THE WINDFALL PROFITS TAX

SIGMA supports the repeal of the windfall profits tax. Repeal would provide greater incentives for investment in domestic exploration and production without imposing additional costs on other sectors of the American economy. SIGMA also believes that the windfall profits tax is unjustified because it generates no additional revenue.

A. Repeal of the Windfall Profits Tax Would Provide Greater Incentives for Investment in Domestic Oil Exploration and Production

SIGMA supports the repeal of the crude oil windfall profits tax because repeal would provide greater incentives for domestic crude oil exploration and production. More domestic production would help to ensure a continuous and abundant supply of petroleum products. Currently, the tax substantially restricts the potential return on investments made in crude oil exploration and production, which artificially depresses investment in such activities. Repeal of the tax would eliminate this artificial barrier, and encourage more domestic exploration and production, which ensures a greater supply of domestic refined products at competitive prices.

Increased domestic exploration and production will diminish U.S. dependence on foreign oil. In the event of a shortage caused by foreign supply disruptions, the United States would be in a better position if it increases its domestic production. However, the windfall profits tax discourages investment in domestic production because it reduces the potential gains for investors who might otherwise be willing to make investments in domestic production. The volatility of the price of oil is well demonstrated, even without severe supply disruptions. Investors who are unable to benefit fully from the increasing prices of oil will seek investments where their gains are not limited by a tax such as the windfall profits tax. Repealing this tax will encourage more investment which will help to insulate America against the effects of a severe supply disruption.

Repeal of the windfall profits tax, unlike an oil import tax, will eliminate an impediment to domestic production without hurting other sectors of the economy. An oil import tax would allow domestic producers and refiners to increase the price of oil and refined products because foreign oil and refined products, which compete for the United States market, would carry the extra cost of the tax. Such increased prices for oil and refined products hurt many American industries, such as manufacturing, transportation, mining, and petro-chemicals, by increasing their energy costs significantly.

Repeal of the windfall profits tax, however, would help to reduce energy costs for domestic industry. Repeal would eliminate the extra cost of the tax and burdensome recordkeeping and reporting requirements which currently place domestic producers at a competitive disadvantage with foreign producers that do not pay the tax. Moreover, repeal would provide additional incentives for domestic exploration and production without increasing the energy costs of American industry, as an import fee would.

B. The Windfall Profits Tax Generates No Revenue and Is Not Projected to Generate Revenue in the Future

Retaining the tax is unjustified because it generates no revenue. The CBO has estimated that over the next five years, the windfall profits tax will generate little or no revenue. In light of the negative impact on domestic exploration and production, there is no basis for keeping the tax.

II. SIGMA OPPOSES A BROAD-BASED PETROLEUM TAX

SIGMA opposes a broad-based petroleum tax because it is inflationary. Any broad-based petroleum tax would increase costs for American industry, which would pass on those costs in the form of higher prices to consumers. Increasing costs for American industry will slow economic growth and reduce American competitiveness.

A. A Broad-Based Petroleum Tax Would Impose Excessive Energy Costs On American Industry

SIGMA opposes a broad-based petroleum tax because such a tax would increase the costs to American industry of all energy resources, not just refined petroleum products. A broad-based petroleum tax would increase the price of petroleum products, which would allow the prices of alternatives such as coal and natural gas, to rise as well. Thus all sources of energy would become more expensive.

In addition, such a tax would make petroleum products artificially less competitive with coal and natural gas. An artificial price increase imposed on petroleum would allow other energy suppliers to raise their prices. However, other energy suppliers would not raise prices the same amount as the tax. Thus, coal and natural gas producers would be able to undercut the increased cost of the tax on petroleum. Sellers of petroleum products would lose a share of their market to coal and natural gas, and at the same time, large consumers of energy, such as important segments of American industry, would pay higher prices.

A broad-based energy tax is an expensive way to raise revenue. The increased prices for energy that American industry would pay will echo throughout the economy. Consumers will face higher prices for all goods for which the cost of energy is an important element of the cost of manufacturing. In addition, American consumers will face higher prices directly in the price of motor fuels. These increased prices for American goods will fuel inflation, slow economic growth, and make American products less competitive with foreign goods both at home and abroad.

III. SIGMA OPPOSES ANY TARIFF ON IMPORTED CRUDE OIL OR PETROLEUM PRODUCTS

SIGMA opposes the imposition of an import tax on crude oil and petroleum products as a means of raising revenue, whether that tax is a flat per barrel assessment or a variable fee based upon the average world market price of petroleum. SIGMA is particularly opposed to an import tax which imposes a higher tax on petroleum products than on crude oil. All proposed provisions for an import tax would detrimentally affect the competitive market position of SIGMA members, and would hurt competition in the petroleum industry. The proposed provisions would also hurt those industries which rely heavily upon petroleum in their manufacturing. Moreover, imposition of an import tax on petroleum would not promote national security and would create unnecessary and burdensome governmental bureaucracy.

A. An Oil Import Tax Will Detrimentally Affect Competition in the Petroleum Industry

Any type of oil import tax would artificially increase the cost of crude oil and petroleum products for consumers, firms in the petroleum industry, and firms in industries in which petroleum is part of the cost of providing the product or services generated by that industry. Any revenue raised from the imposition of such taxes would be more than offset by the increase in these costs. Thus, these proposed taxes are an inefficient, as well as, ineffective means of raising revenue.

Whether the tax is on crude oil or on particular petroleum products, costs in the domestic petroleum industry would increase. Any tax on producers of imported crude oil and/or petroleum products will not be entirely absorbed by the producers of such goods. At least part of the tax will be passed on in the cost to the U.S. purchasers. In addition, prices of domestically produced crude oil and petroleum products will increase. This effect would occur because an increase in the price of imported petroleum through an artificial means such as an import tax provides the impetus to increase the domestic price of petroleum proportional to the increase in the imported product even though the domestic producer incurs no such cost. Moreover, an oil import tax would seriously injure competition within the oil industry because of the ability of vertically integrated major oil companies to establish the price of crude oil in the domestic market. These companies can establish these prices as a result of: (1) their own very substantial production; (2) their dominance over the gathering and transportation systems employed to move most crude oil; and (3) the fact that their refineries represent at least 70 percent of the market for domestic crude oil.

An oil import tax will give these vertically integrated companies greater control over the domestic industry to the detriment of independent marketers' and independent refiners' competitive position. This shift in market power, and corresponding increased profits, do not mean that the vertically-integrated oil companies will increase their oil exploration programs or improve efficiencies.

Any oil import tax which imposes a higher fee on finished petroleum products than on crude oil ("a differential") would be especially injurious to independent marketers and to consumers, while benefitting only a narrow sector of the United States economy. A differential would effectively foreclose access to foreign products and thereby weaken marketers' competitive position. The higher levy on product imports would price us out of the market. With access to imports restricted, domestic refiners would have little incentive to sell motor fuels to independent marketers at competitive prices. In the absence of competition from independent marketers, domestic refiners could raise their gasoline price considerably.

B. An Oil Import Tax Will Economically Hurt Energy-Intensive Industries, Other Consumers and the General Economy

The limited revenues raised by an oil import tax would be further offset by the negative effects of a tax on sectors of the U.S. economy other than the oil industry. These effects will result because, unlike other revenue raising measures, an oil import tax has the dual effect of raising revenue and causing price levels to rise.

Energy price increases necessarily raise producers' costs, particularly in energy-intensive industries. Particularly hard hit will be such energy-intensive industries as petrochemicals, agriculture, airlines, mining, and manufacturing. The increased costs attributable to an oil import tax would fuel inflation in the domestic economy because the prices for the products generated by these industries would necessarily increase. Inflation would slow economic growth and weaken the competitiveness of the domestic industries vis-a-vis their foreign counterparts, thus, hurting further the international trade imbalance of the United States. These serious economic ramifications counsel against the enactment of an oil import fee.

An oil import tax would also have a negative impact on energy consumers and the government. Price increases would result in reduced income tax payments (because of decreased profits) from energy consumers and increased government outlays. These outlays would include expenditures tied to cost-of-living increases, such as unemployment, and entitlement programs including welfare, federal retirement and food stamps. They also would include discretionary outlays, such as military spending for gasoline and jet fuel. Much of the additional consumer outlays for energy would go to the domestic oil companies and not to the government. A fundamental principle of taxation should be that all funds reallocated in the economy by a tax should go to the government, rather than private companies.

By raising energy prices, an oil import tax also would increase inflation; raise nominal interest rates (since, with increased prices, the economy will seek to finance more transactions); drive down investments; and reduce the real wealth of consumers (especially since producers will attempt whenever possible to transfer their increased costs forward to consumers). In sum, a tax would produce results that typically flow from protectionism. Domestic energy industries will gain in the short run, but the gains to those companies and to the U.S. Treasury will be more than offset by losses in income and employment elsewhere in the economy.

C. Minimal Governmental Intervention in the Oil Industry Should Be a Basic Tenet of United States Energy Policy

Despite the considerable benefits to the American people of a free marketplace, and the clear detriments which would result from an oil import tax,proponents of an oil import tax have attempted to justify new government intervention on the ground that the absence of controls on oil imports could lead to a security-threatening dependence on imported energy. They argue that an oil import tax would prevent such dependence by stimulating domestic exploration and exploitation of new reserves and reducing domestic consumption. An oil import tax, far from being sound energy policy, is an invitation to repeat the mistakes of the past.

There is no question but that the present policy with respect to imports is the wisest. For the first time in decades, United States energy policy is competitively neutral with respect to imported crude oil and petroleum products. The present policy has provided a level playing field for all sectors of the oil industry. By dismantling many of the governmental protections previously afforded to crude oil producers and refiners, the government has allowed the forces of supply and demand to operate, thereby minimizing market distortion. The effects of this deregulation have been beneficial. Prices of oil have declined. United States sources of supply are diversified and much more secure than in the 1970s.[1/]

Dependency, however does not automatically equate to a national security threat. Given the fact that the U.S. oil industry is "mature" and limited in resources, the United States will always have to rely on foreign sources of supply unless it is to burden its people and its industry with energy costs that are much higher than other countries against whom we must compete. A vital port of our national security is keeping our industry healthy and competitive in a world marketplace. Our industry will deteriorate if our energy costs are higher than our foreign competitors. National security must be measured by our vulnerability to supply interruptions.

A determination of whether the United States' national security is in danger must be based upon an examination of the sources of foreign supply as well as the other measures the United States has undertaken to protect against supply disruptions. Through an adequate Strategic Petroleum Reserve ("SPR"), and with the development of numerous and diverse suppliers, the United States can lessen its vulnerability to supply disruptions without harming its domestic industry thereby rendering it weak and vulnerable.

1/ Today, 50 percent of U.S. imports of crude oil and petroleum products come from suppliers in the Western Hemisphere. Over 37 percent of crude oil and petroleum product imports come from Canada, Venezuela, and Mexico. Only 18.15 percent of imports of crude oil and petroleum come from Arab OPEC countries.

The petroleum problems which occurred in 1973 and in 1979 resulted from an inadequate SPR[2] and from a dependence on foreign supply from the middle eastern countries. The SPR currently is sufficient to withstand a total import interruption from Arab OPEC suppliers of more than 512 days. Additionally, the United States imports its petroleum from over 40 countries. The majority of the petroleum comes from close, allied nations such as Canada, Venezuela, the United Kingdom, and Mexico, with imports from these countries alone amounting to over 46 percent of the crude oil imported by the United States in 1986.

SIGMA believes that the current level of oil imports does not threaten the status of United States' national security. However, even if there were a threat, the imposition of an oil import tax is the least efficient means the government could utilize to enhance national security.

D. A Differential Oil Import Tax will not Strengthen National Security

Proponents of a tax which imposes a higher tax for petroleum products than for crude oil (a "differential") contend that it is needed to protect the United States' national security. In particular, certain refiners have argued that the national security is threatened by the continued decline in the United States' refining capacity. This assertion is fallacious for two reasons. First, imports are not the cause of the decline in refining capacity. Second, the situation at present, and for the foreseeable future, is not one in which there is a threat to the national security.

The cause of the decline in United States refining capacity since 1981, the entitlements program and crude oil price controls created artificial incentives for the construction and expansion of domestic refining capacity. Domestic price and allocation controls directed the development of the domestic industry while OPEC policies dominated the foreign crude and refining markets. Construction of new facilities outpaced growth in product demand, leading to a capacity surplus in 1980 for the first time since 1962.

With decontrol in 1981, competition returned as the norm for an industry that had learned to look to the government for the establishment of goals and incentives. Overcapacity in crude oil production and refining capacity is well-documented and, in fact, admitted by those seeking protectionist legislation. It is generally acknowledged that mostly small, inefficient refineries and older refineries not possessing state-of-the-art technology have closed. This process is the natural result of a marketplace adjusting to lower demand from overcapacity.

Protectionists would like you to believe that their problems are caused by an overwhelming flood of imports. The facts show otherwise.

Finished motor gasoline imports constituted only 4.8 percent of United States consumption during the first quarter of 1987; this represents a drop in imports of motor gasoline from 1985 when such imports constituted 5.6 percent of United States' consumption. Imports of finished petroleum products (motor gasoline, aviation gasoline, jet fuel, kerosene, naphtha, distillates, residual fuel, lubricants, waxes, petroleum coke, asphalt, and road oil) averaged only 9.4 percent of United States demand in 1986. In

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[2] The SPR was not in existence in 1973. In 1979, the SPR was still in its infancy.

1986, total U.S. production of finished petroleum products increased 4.78 percent as compared to U.S. consumption which increased by only 3.94 percent.[3]

Much is made of the number of refineries which have closed since January 1981. Most of the refineries that have closed since 1981 are those small refineries that benefited from government protection in the 1970s. Thus, over 85 percent of the 122 refineries reported to have ceased production as of January 1, 1986 were refineries with less than 50,000 barrels per day production capacity. Eighty-five had a capacity of 30,000 barrels per day or less. Forty-nine of those refineries were opened immediately prior to or during the period of small refiner protection. Preliminary figures from the United States Department of Energy show that only four small refineries with a capacity of less than 45,000 barrels per day closed during 1986. But during this same period, seven new refineries were opened or reactivated. This situation constitutes a reversal of the 1981 to 1985 trend and suggests that the period of adjustment has ended.

Efficient refiners were generally quite profitable in 1986. During the first and second quarters in 1986 all of the largest 13 integrated and independent refiners except one earned sizable profits on their refinery and marketing operations.[4] In addition, eight of the 13 principal refiners reported increased profits from refining and marketing from the first quarter to the second quarter of 1986.

Certain refiners point to imports of products from Arab OPEC refineries, arguing that they constitute a threat from which the United States refining industry needs protection. There is no indication of any such threat in the foreseeable future for despite the opening of several new refineries, imports from these sources are at low levels and have not increased appreciable.[5]

The United States has ample refining capacity in case of an emergency.[6] Department of Energy statistics show that the United States presently has more than enough refining capacity to meet domestic needs. In addition, the United States is less vulnerable to supply interruptions than at any time in the past twenty years because imports come primarily from secure and reliable sources. According to Department of Energy statistics, 50 percent of product imports come from Western Hemisphere sources. In contrast, total product imports from all Arab OPEC nations amounted to only 12.02 percent of United States imports in the first quarter of 1987. Our neighbors

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3/ U.S. Department of Energy, Energy Information Administration, Petroleum Supply Monthly, March 1978 (June 1987).

4/ Refining and marketing profits are generally combined in financial reports and not reported separately.

5/ Product imports from Saudi Arabia, for example, were only 2.93 percent of total imports (less than one-fourth of one percent of domestic refined supply) in 1986. Indeed, far from increasing their production, the Saudis have taken steps to curtail their product output. For example, in 1985, Saudi refiners postponed indefinitely plans for two new refineries, at Riyadh and Ras Tanora, that would have expanded production capacity by 450,000 barrels per day.

6/ Current demand for all petroleum products in 1986 averaged 16.09 million barrels per day. U.S. Department of Energy, Energy Information Administration, Petroleum Supply Monthly, March 1987 (June 1987).

currently supply 68 percent of all residual fuel imports in the United States, 80 percent of all imported distillates, and 55 percent of all gasoline imported into this country.[7/]

Motor gasoline imports from Canada and Venezuela have increased in relation to imports from other United States suppliers over the past several years. Canadian gasoline imports, for example, have increased from six percent of gasoline imports in 1984 to over nine percent in 1986.[8/] Western Hemisphere sources such as Mexico and Venezuela have proven reliable during past emergencies and crises and are secure from the war and turmoil that threatens the Middle East. In addition, transportation from sources such as Canada, Mexico, and Venezuela is quick, and not subject to long delays.

Those relatively few product imports from other sources derive from a variety of suppliers, thus ensuring against excessive United States dependence on any one country or group of countries. Motor gasoline imports in 1985 and 1986, for example, were obtained from over 20 exporting countries, most of which are traditional suppliers located outside of the Persian Gulf.

This situation is unlikely to change significantly in the foreseeable future. Our Western Hemisphere neighbors will continue to be a secure and stable source of imported petroleum products because of their considerable petroleum reserves[9/] and proximity to United States markets. In addition, there is no evidence that imports from suppliers outside of the Western Hemisphere (which because of their distance from the United States are more vulnerable to supply interruptions) will increase above their present low levels.

In sum, there is little evidence of a national security threat from petroleum product imports at present or for the foreseeable future. The secure position that America enjoys is evidence that the present energy policy is well-suited to ensure against a threat to our national security. A neutral policy with respect to oil imports has encouraged and resulted in a diversity of suppliers, virtually all of whom are reliable and secure from disruption.

E. An Oil Import Tax Cannot be Properly Regulated Without a Vast, Expensive and Inequitable Government Bureaucracy

Finally, history has shown that oil import taxes and quota programs inevitably spawn a vast, expensive and inequitable government bureaucracy. The bureaucracy required to administer the Mandatory Oil Import Program is a case in point. The complex regulations and exceptions procedures created under that program constituted unnecessary government intervention in an industry that would have served United States consumers far better had it been left unregulated. Adoption of an oil import tax would necessitate the reestablishment of a similar administrative apparatus

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[7/] U.S. Department of Energy, Energy Information Administration, Petroleum Supply Monthly, March 1977 (June 1987).

[8/] U.S. Department of Energy, Energy Information Administration, Petroleum Supply Monthly, March 1977 (June 1987).

[9/] Mexico, Canada, and Venezuela all rank among the top 17 oil producing nations in official reserves.

to implement the tax and to deal with the inevitable exception requests. Indeed, some of the proposed provisions already envision exemptions from the tax's application. The likely difficulties that would be encountered in determining how to apply such exemptions are reminiscent of the complex and involved regulatory problems that arose under the Mandatory Oil Import Program and price and allocation controls.

An oil import tax would encourage the use of expensive, limited reserves located in the United States. Draining America first might discourage immediate vulnerability, but in the long run would leave the United States even more dependent upon foreign oil supplies. An oil import tax also would uniquely increase the costs of energy-intensive domestic industries, thereby rendering them less competitive in the world market. Further, an oil import tax would-distort the competitive structure of the domestic petroleum industry. Finally, an oil import fee would lead unavoidably to the creation of a large and unwieldy government bureaucracy to administer it.

In summary, the past five years have demonstrated the wisdom and desirability of decreasing governmental intervention in the petroleum market. Minimal governmental intervention has helped the overall economy by lowering the prices of goods produced from oil and by helping stabilize inflation.

SIGMA opposes the enactment of any form of oil import tax. Such a tax would distort the competitive structure of the petroleum industry to the detriment of independent marketers, independent refiners, and consumers. Moreover, an oil import tax would raise energy costs for domestic industries, impairing their competitive position in world markets.

SIGMA emphasizes that any oil import tax which imposes a higher fee on imports of products than is imposed on imports of crude oil is unjustifiable and would irreparably damage the competitive viability of independent marketers. The minimal share of the domestic market for petroleum products which is supplied through imports, coupled with the profitability of the refining segment of the petroleum industry clearly, demonstrate that protection for domestic refiners is unjustified and would result in an enormous windfall to them at the expense of consumers and the economy in general.

IV. SIGMA OPPOSES INCREASING THE MOTOR FUELS EXCISE TAX RATES BECAUSE SUCH ACTION IS REGRESSIVE

SIGMA opposes increasing motor fuels excise tax rates because such an action is regressive. The burden of the increase would fall disproportionately on those who are least able to pay for the increase as the tax simply increases the cost of motor fuels for all customers. Individual motorists are not likely to alter their driving habits to avoid the higher costs because they have come to rely on their vehicles for necessary transportation. For many, no viable alternative to driving exists. Increasing motor fuels excise taxes will also have an acute impact on those that rely on public transportation. Thus, the regressivity of the increased tax is demonstrable as those who would feel the impact of the increase most are also least able to afford or avoid it. The regressivity of this proposal is unfair to American consumers of motor fuels.

V. SIGMA OPPOSES COLLECTION OF GASOLINE EXCISE TAXES UPON REMOVAL FROM THE REFINERY

SIGMA opposes collection of gasoline excise tax upon removal from the refinery because it will favor certain industry segments over others, and it is not administratively more efficient than the system adopted just last year in the Tax Reform Act of 1986. Terminal operators that compete with refiners will be saddled with additional costs not borne by their refiner-competitors. Terminal operators that mix blend stocks will have an unfair advantage over operators that do not mix blend stocks. Moreover, Congress already settled the issue of administrative efficiency, and a redetermination is unwarranted. If enacted, this proposal would create inefficiencies in the wholesale distribution system and impose administrative burdens on the gasoline industry and government alike.

A. Collecting Gasoline Excise Taxes Upon Removal from the Refinery Will Impose Insurmountable Competitive Disadvantages on Many Independent Terminal Operators

SIGMA opposes collection of gasoline excise taxes upon removal from the refinery because it will add built-in costs for the operation of independent terminals that compete with refiners. Under this proposal, refiners would not carry inventory with the built-in costs of the tax because they would be collecting and holding the taxes which the independent operators are paying and carrying in the cost of inventory. Not only would this cost be measured by the amount of the tax which the terminal operator pays, refiner, but it is also measured by the fact that this tax would not be paid to the government directly. Rather the tax would be paid directly to competitors that hold it until payment to the government. Consequently, refiners would earn interest on the "float" that terminal operators formerly earned. The anticompetitive effect of moving the tax up to removal from the refinery is thus doubly burdensome as the "float" is lost to the terminal operators and gained by refiners with which they compete.

In sum, it is simply not true, as the committee staff's exploranation of its proposal states, that imposing the tax upon removal from the refinery will eliminate any special advantage for a single industry segment. It would give an advantage to local refineries that compete with independent terminal operators. To the contrary maintaining the system envisioned by the 1986 amendments would achieve competitive neutrality.

B. Terminal Operators that Mix Blendstocks Will Have an Advantage Over Those That Do Not

This proposal would give an advantage to terminal operators that mix blend stocks because they would be able to carry inventory on which tax has not been paid. Terminal operators that mix blendstocks and additives are able to increase the volume of taxable gasoline that they ultimately sell. Because a portion of the ultimate gallonage is untaxed, the terminal operator has gained a measurable advantage over the terminal operator that is not able to increase the volume at its terminal. Although the terminal operation at some time would pay the tax on the additional volume that leaves the terminal, the price of the gasoline will reflect the terminal operator's ability to carry tax-free inventory. Operators that perform no mixing will carry no tax-free inventory and they will experience a competitive disadvantage.

Moreover, if a terminal operator that mixes blendstocks collects the tax from customers, then the operator has the benefit of the "float" until it is time to remit the tax payments to the government. Thus, the terminal operator that does not mix blendstocks experiences a compounded disadvantage of not being able to spread the cost of the tax over more gallons and not receiving any "float."

C. No Administrative Efficiency Will Be Gained

Because blending may increase volume, the government will lose efficiencies that the proposal purports to gain. The government will have to monitor those terminals where blending occurs and volume is increased. This proposal purports to reduce the number of entities that the government monitors to assure compliance. However, the increase in volume by mixing at the terminal thwarts that purpose; the government must monitor the terminal operators that increase volumes for collection of the tax at a later point in the distribution chain.

Congress should recognize that enactment of this proposal will not generate efficiencies. Rather, such action will disrupt the market structure for the sale and distribution of gasoline by giving an advantage to terminal operators that have the capacity to mix blend stocks over those that do not. This advantage not only would be unfair, but also would be the source of unnecessary administrative complexity.

Congress already settled the issue of administrative efficiency in last year's tax bill. At that time Congress determined that bulk transfers to terminal operators would be tax free and that the taxable event for such bulk transfers would be removal from the terminal. This action decreased the number of entities that required monitoring from over 8,000 to under 1,000. Congress settled the issue of the administrative efficiency at that time and should not alter its decision now.

In sum, SIGMA opposes this proposal because it would disrupt the current market structure for the distribution of gasoline. The current structure assures access to competitively priced supplies which allows independent marketers, such as SIGMA's members, to compete effectively. Thus, consumers are assured of abundant supplies of motor gasoline at lower prices. Enactment of this proposal would endanger the competitive environment in which SIGMA's members now operate.

VI. SIGMA OPPOSES ELIMINATING THE EXEMPTIONS FOR ALCOHOL FUELS

SIGMA opposes eliminating the exemptions for alcohol fuels. The exemption encourages the production and sale of alcohol fuels. The availability of competitively priced alcohol fuels is an important component of the pricing structure for gasoline. Alternative fuels, such as ethanol, help to keep gasoline competitively priced. The U.S. has an abundant supply of products, such as corn, from which alcohol fuels can be made. The incentives created by the exemption help to reduce U.S. dependence on imported petroleum products as the increased use of alcohol fuels reduces U.S. demand for products that are only petroleum-based.

VII. CONCLUSION

In sum, SIGMA supports repeal of the windfall profits tax and opposes a broad-based petroleum tax, an oil import tax, increasing motor fuels excise taxes, moving the collection of excise taxes up to removal from the refinery, and eliminating the exemption from excise taxes for alcohol fuels. SIGMA's positions reflect SIGMA's interest in maintaining a competitive marketplace for motor fuels and avoiding burdensome administrative problems for both industry and government.

UNITED STATES CONFERENCE OF MAYORS
1620 EYE STREET, NORTHWEST
WASHINGTON, D.C. 20006
TELEPHONE (202) 293-7330

STATEMENT OF THE U.S. CONFERENCE OF MAYORS
ON REVENUE INCREASE OPTIONS
SUBMITTED FOR THE RECORDS OF THE COMMITTEE ON WAYS AND MEANS

JULY 15, 1987

The U.S. Conference of Mayors understands and supports the need to raise additional revenue in order to reduce the FY88 federal deficit. We also recognize how politically sensitive and difficult it is to raise revenue in an equitable and sensible manner. In cities across the country, mayors have had to raise taxes nearly every year of the past decade, tap new and sometimes innovative tax sources, win approval from state legislatures for wider tax latitude for cities, and in some cases, win public referenda to raise taxes. Because of the obstacles placed in our path, our task is often more difficult than yours.

We are hopeful that this committee and the Congress will not make our job more difficult by necessitating additional tax increases at the local level or by undercutting our ability to raise local taxes and finance important projects.

In particular, we are concerned about proposals to mandate Medicare coverage of all state and local employees, to eliminate the deductibility of personal property taxes, to terminate the state and local government exemption from federal gasoline taxes, and hamstring further the ability of cities to issue tax-exempt debt.

Medicare Coverage: Only last year the Congress confronted the issue of Medicare coverage of state and local government employees and decided to phase in Medicare coverage gradually.

Cities have been proceeding in good faith to comply with this law, developing and administering retirement systems which rely in part on federal Medicare and Social Security systems.

It seems unfair and capricious to alter the rules now. It would be extremely difficult and costly for cities to adjust immediately to a new system of mandatory Medicare coverage. Local budgets are already in place for the next fiscal year and contracts signed for medical benefit and retirement programs for current employees. Moreover, the costs associated with immediate Medicare coverage are immense for cities across the country.

If this option were adopted, the only alternative available to most cities would be to increase local taxes or to cut expenditures dramatically. Thus, the federal government would be once again transferring debt problems to other levels of government which have relied in good faith on existing federal law and commitments. The Conference of Mayors strongly opposes immediate mandatory Medicare coverage of state and local employees.

Personal Property Taxes: We oppose any repeal of the personal property tax deduction. Increasingly, cities have turned to such taxes as a way to balance local budgets, especially since last year's tax law, which gave a clear message to cities that state and local property and income taxes would continue to be deductible.

Gasoline Tax Exemption: The Conference of Mayors is opposed to the proposed repeal of the current exemption from gasoline taxes for state and municipal vehicles. If this option were adopted, cities would be forced to increase their own taxes in order to maintain current police, fire, and ambulance services, to continue school bus transportation and to operate heavy trucks necessary for road construction and other infrastructure repair and construction.

It is not a viable option for cities to curtail their gasoline purchases. Repeal of our current exemption would have one certain result -- increasing the cost of some of the most important city services.

Moreover, it seems patently unfair to repeal the exemption for states and localities but not for the federal government, nor to include as part of the option permission for state and local governments to levy gasoline taxes on federal vehicles which use state and local streets and highways.

Municipal Bonds: The Conference of Mayors opposes any further federal encroachment on the municipal bond market. We still do not have the Treasury Department's regulations on the last tax act, which continues to cause substantial uncertainty for cities.

The municipal bond market has had to weather a great deal of uncertainty for some time now, because of the Congress' proclivity to legislate restrictions on bonds, in each of the last three tax bills. Moreover, even the introduction of legislation by a member of this committee is enough to throw the market into disarray.

In particular, there are three proposals contained in your "laundry list" of revenue options which concern us.

First, we understand the desire to increase the individual minimum tax, but the proposals to increase the rate from 21 to 26 percent and to repeal the exemption for general obligation and municipal revenue bonds would do much damage to the ability of cities to finance important services and projects. In reality, all bonds would then be taxable, substantially increasing the cost to local governments and to all taxpayers of issuing bonds for important projects. In addition, an increase in the rate alone would further restrict the marketability of bonds for low-income housing, airports and economic development.

Secondly, the proposal to reduce the state volume caps would reduce further the ability of cities to encourage investment in low-income housing and make privatization even more impossible than it already is now.

Thirdly, increasing the alternative corporate (book income) minimum tax would increase the cost of municipal borrowing by further decreasing the market for bonds. As a result, it would be more expensive and difficult to finance jails, schools, hospitals, and other public facilities and services.

Other Proposals: The Conference of Mayors does not think it is sound Congressional policy to make across-the-board cuts in a large number of deductions and credits, notwithstanding the simplicity of the approach. We believe that some deductions and credits should be part of our tax code; others, no doubt, should be eliminated. By lumping all together, regardless of their merits or flaws, Congress would be evading its responsibility of making needed, albeit tough, decisions.

Three of the tax credits proposed to be cut by 20 percent (along with several other credits) particularly concern us -- the low-income housing credit, the targeted jobs tax credit and the historic rehabilitation tax credit. These credits have been very important tools in stimulating the employment of disadvantaged workers, including welfare recipients, in promoting the architectural beauty of urban areas and in providing homes for low income citizens.

We are also opposed to the option to disallow interest deductions for installment sales to municipal government. This will increase the expense to cities of purchasing fire trucks, police cars, computers and other equipment.

We thank you for this opportunity for the Conference of Mayors to submit our views to this committee. We would be happy to continue this dialogue with you as you strive to find additional revenues as mandated by the FY88 budget resolution.

STATEMENT OF RONALD G. WASSON
ON BEHALF OF THE
WESTERN COAL TRAFFIC LEAGUE

Introduction

My name is Ronald G. Wasson, and I am presenting this testimony on behalf of the Western Coal Traffic League (the "League"), a voluntary association of electric utility organizations located West of the Mississippi River that purchase and consume almost 50 million tons of bituminous coal each year. The Appendix lists the current League Members.

I also serve as Vice President of Administrative Services for the Kansas City Power & Light Company ("KCP&L"), a League member. KCP&L is a medium-size electric utility headquartered in downtown Kansas City, Missouri, that provides electricity to a service area with a population of about 825,000. This statement is presented not only on behalf of the League members like KCP&L, which include investor-owned, public, and nonprofit rural cooperative utilities, but also on behalf of our millions of electric customers.

My purpose in presenting this Statement is to urge the Committee to reject any attempts to (a) increase the coal excise tax that is used for the Black Lung Disability Trust Fund, (b) to impose a broad-based energy tax on either a BTU or ad valorem basis, or (c) eliminate the percentage depletion allowance for coal and other natural resources, as discussed at pages 12-14, 53-56, and 248-49 of the publication of the Joint Committee on Taxation entitled "Description of Possible Options to Increase Revenues Prepared for the Committee on Ways and Means," which is the subject of this hearing.

All citizens and residents of the United States -- and especially utilities, their owners, and their electric customers -- have a strong interest in economic stability and growth. The purpose of this Statement is simply to explain that the coal measures are a particularly inappropriate way to reach these goals since, as discussed below, (a) increased taxes on coal are simply a regressive tax on the general population, (b) coal is already highly taxed, and (c) increased coal taxes are likely to frustrate, not facilitate, the intended benefits of deficit reduction. For these reasons, we urge that the Committee give no further consideration to increased coal taxes.

Factors that Weigh Against Increased Coal Taxes

A number of compelling factors weigh against any increase in the coal excise tax used for black lung disability payments, the adoption of any broad-based energy tax on either a BTU or ad valorem basis, and repeal of the coal depletion allowance.

First, it must be understood that a tax on coal is simply a tax on the consumers of coal, who are the everyday citizens of America. While it might be tempting to speculate that the burden of the tax will be carried by the so-called "big energy" companies, such is not the case because the coal suppliers will inevitably pass the tax along to their customers, the utilities, who will then pass it along to their customers, the everyday ratepayers. Indeed, it is very easy to demonstrate that the tax will be passed through in this fashion. As a natural law of economics, it is clear that the price of an object must cover the cost of production, which includes any taxes. Not only is this a basic economic fact, but the long-term contracts that govern much of the coal purchased by utilities generally contain quite specific "pass through" provisions that require that the customer pay any additional costs incurred by the producers -- specifically including excise taxes, health-related costs, property or value taxes, and reductions in the percentage depletion allowance. Likewise, the utility that buys the coal from the producer will pass the tax, along with other costs of acquiring and burning the fuel, to the ratepayers as part of the monthly electricity bill. These consumers will thus ultimately bear the burden of any increased tax on coal.

Second, it is essential to recognize that electricity is in no sense a luxury or a "vice" item, and that consumers of electricity have little control over how much electricity they use. Electricity is truly a staple of modern life, and consequently any increase in coal taxes is likely to have a highly regressive effect on low-income families. Of course, these persons are the ones already hit hardest by the problems caused by the deficit. Hence, increased coal taxes will expose them to a form of economic whiplash from first the deficit, and then second the supposed solution. Such increased taxes would also fall disproportionately on small businesses, particulary in the service sector, which hold the greatest potential for providing the economic growth that can ultimately reduce and eliminate the deficit. Moreover, as electricity is an input cost for virtually every item manufactured and for every business, increased energy taxes must inevitably contribute to general inflation and reduced competitiveness throughout the economy. In short, when it comes to increasing coal taxes in order to reduce the deficit, the "cure" may be worse than the disease, and the "cure" may well frustrate the only real long-term solution to the underlying problems.

Third, insofar as increased energy taxes (particularly the black lung tax which affects only coal and none of its fuel competitors) result in diminished domestic energy production, the taxes will further contribute to decline in U.S. competitiveness and adversely affect the coal-related sectors of the economy. Congress considered this factor when it increased the black lung tax rate by 10% in the Consolidated Omnibus Budget Reconciliation Act of 1985. No development since that time could possibly warrant a further increase, especially since, as noted in the Committee print at page 13, increased taxes will reduce the ability of United States coal producers to export their coal, which again will mean a higher deficit, a lower exchange rate, and greater deficits. Moreover, an increase in the coal excise tax or a reduction or elimination of the coal depletion allowance will increase the incentive to import coal for use by domestic utilities, thus creating additional economic difficulty. In short, this is yet another area where the "cure" of increased coal taxes is worse than the disease.

Fourth, and perhaps most importantly, coal is already taxed very highly. Consider for a moment the litany of state and Federal taxes to which coal is exposed. First, on the state level, coal is subject to severance taxes as well as gross proceeds, resource indemnity, and ad valorem taxes, to name but a few. In Montana, the severance tax alone has in the past been 30%, and there is also a gross proceeds and resource indemnity tax. The Federal government imposes not only the black lung tax, but also an abandoned mine reclamation fee that together typically amount to $.90 per ton. In addition, for coal mined on lands leased from the Federal government, which is true of much of the low-sulphur coal mined in the West that League members consume, there is a 12.5% Federal coal royalty, which because it is presently applied to all of the mark-ups on the coal, actually results in a tax rate as high as 17.5% or more. Hence, taxes and fees can result in a 50% or greater increase in the cost of coal, not including Federal, state, and local income taxes. Coal clearly already carries more than its fair share of the burden.

Moreover, in recent years, coal has been hit hard with increased taxes and fees. The Federal Coal Leasing Act Amendments of 1976 increased Federal coal royalites by as much as 4000%, and the black lung tax was increased in 1986. Furthermore, the depletion rate for coal -- but not other energy fuels -- was singled out for a 15% reduction in the Tax Equity and Fiscal Responsibility Act of 1981, and an additional 5% reduction in the Tax Reform Act of 1986. Indeed, the black lung tax is itself a recent invention that started out at only 2% in 1978 for the surface mines that provide coal to League members. As surface mines do not cause the black lung disease, even the present 4.4% tax seems excessive. Clearly, no further increases in taxes and fees for coal are needed.

Conclusion

While reducing the Federal deficit is a laudable goal, increasing the taxes on coal is a wholly inappropriate means of achieving that lofty end. Coal is already taxed very heavily, especially when one considers that it is in no sense a luxury or vice-type of item. Also, coal fees and taxes have recently faced disproportionate increases, and any further increase will fall on those least able to afford it, who are, of course, those most affected by the problems that flow from the deficit. Not only is the cure worse than the disease for these individuals, but the cure will also frustrate the future economic growth that is ultimately essential for elimination of the deficit. Under these circumstances, the last thing that this country needs is increased taxes on coal.

APPENDIX

MEMBERS
WESTERN COAL TRAFFIC LEAGUE

Arizona Electric Power Cooperative, Inc.
Central Louisiana Electric Company, Inc.
Central Power and Light Company
City of Austin
City of Colorado Springs
City Public Service Board of San Antonio
Iowa Public Service Company
Kansas City Power & Light Company
Lower Colorado River Authority
Minnesota Power
Omaha Public Power District
Tuco, Inc.
Unitrain, Inc.
Utility Fuels, Inc.

STATE AND LOCAL MEDICARE PAYROLL TAX

ALSIP PROFESSIONAL FIREFIGHTERS ASSOCIATION

AFFILIATED WITH INTERNATIONAL ASSOCIATION OF FIRE FIGHTERS AFL-CIO-CLC

LOCAL #3074

June 23, 1987

The Honorable Dan Rostenkowski
U.S. House Of Representatives
Washington D.C. 20515

Dear Congressman Dan Rostenkowski,

We're writing to communicate our strong opposition to mandatory medicare coverage of state and local government employees which is being considered by Congress.

We oppose any further expansion of medicare coverage beyond the new hires provision adopted in 1986. And, we feel we have a legitimate argument against mandatory medicare coverage. For years, state and local government employees were specifically excluded from participation in the medicare system. Great pains have been taken to create sound and secure retirement and health benefits for state and local government employees. Mandatory coverage will disrupt these plans, place them at financial risk and unfairly penalize current employees for the cause of a balanced budget. Furthermore, the increased cost to state and local governments will result in cuts in essential services, including fire fighting, in communities around the nation.

We urge you as our representative to vote against any proposal to include mandatory medicare coverage as a funding mechanism for the catastrophic health care bill. We also oppose any proposal for mandatory medicare coverage in connection with the budget reconciliation bill.

We hope our comments will aid you as you consider this proposed law. We would appreciate a response from you concerning the prospects of this bill. We would be happy to provide more information if you should require it. Your vote on this issue could be crucial!

Thank you for your consideration of our views.

Respectfully,

Joseph J. Madden Jr.

Joseph J. Madden Jr.
President A.P.F.A. Local 3074
11616 S. Karlov
Alsip, IL 60658

cg

ALSIP PROFESSIONAL FIREFIGHTERS ASSOCIATION

AFFILIATED WITH INTERNATIONAL ASSOCIATION OF FIRE FIGHTERS AFL-CIO-CLC

June 23, 1987

LOCAL #3074

Members A.P.F.A. Local # 3074 Opposing Mandatory Medicare Coverage

Members Signatures

R. Hartmann

Terry

Kevin P. Michaels

Robert R. Bunge

Matt Maciaga

Joseph J. Madden Jr.

Joseph M. Schmitt

Charles J. Geraci

AFT AMERICAN FEDERATION OF TEACHERS AFL-CIO
555 NEW JERSEY AVENUE, NW
WASHINGTON, DC 20001
(202) 879-4400

ALBERT SHANKER
President

June 22, 1987

Honorable Dan Rostenkowski
Committee on Ways and Means
U.S. House of Representatives
Washington, DC 20515

Dear Representative Rostenkowski:

The Consolidated Omnibus Budget Reconciliation Act of 1985 required all state and local government employees hired after April 1, 1986, to be covered by the Medicare hospital insurance payroll tax. This provision was adopted after much deliberation as a compromise measure to phase-in mandatory coverage of all state and local employees.

Mandatory Medicare coverage of employees hired prior to April 1, 1986, would place a heavy fiscal burden on state and local govenments and their employees. Many are already hard pressed and could not readily absorb an additional, nearly three percent of payroll for uncovered employees. Mandatory coverage also could disrupt some collective bargaining agreements.

I understand the Ways and Means Committee will revisit this issue. The AFT has opposed, and continues to oppose, mandatory Medicare coverage for the purpose of reducing Federal deficits.

Sincerely,

Gregory A. Humphrey

Gregory A. Humphrey
Director of Legislation

GAH:bdp
opeiu#2
aflcio

Municipality of Anchorage

P.O. BOX 196650
ANCHORAGE, ALASKA 99519-6650
(907) 343-4431

TONY KNOWLES
MAYOR

OFFICE OF THE MAYOR

June 30, 1987

Rep. Dan Rostenkowski, Chairman
House Finance Committee
U. S. House of Representatives
Washington, D. C. 20515

Dear Mr. Chairman:

The Municipality of Anchorage is very concerned about one of the President's budget proposals being considered by your Committee - extending Medicare coverage to state and local employees.

Anchorage, which covers its employees' health and pension funds under its own plan, has complied with the Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA), which mandated Medicare coverage to newly-hired employees after April 1, 1986. The Municipality has been able to induct these new employees into the Medicare system without reducing regular benefits to them. However, if all of our employees are brought into the system at once rather than a phase-in through employee turnover, it would serve as a considerable burden to the Municipality. The proposal would cost the Municipality of Anchorage $700,000 annually, as well as place significant burdens on many other cities and towns in Alaska.

The timing of this proposal could not be worse for us. This change in the Medicare coverage would place needless economic hardship at a time when we are already experiencing financial difficulty. I do not need to tell you what has happened to oil states and their economies as a result of the decrease in the price of oil. We have had to reduce both state and municipal services. State assistance to local government has been cut by more than 20%. The Governor has convened a special session to deal with a still unbalanced budget.

Furthermore, the proposal constitutes a tax increase for these employees that could more than offset the tax cut they are counting on from the Tax Reform Act of 1986. I believe the Committee has been provided with figures that show tax increases to the average state or local employee up to $140 greater than the anticipated tax cut from the 1986 Act. As you are aware, the Alaskan salaries generally reflect our higher cost of living, and are therefore somewhat larger than the national averages. Therefore, the impact on our state and local employees could be expected to be greater.

Proponents of the Medicare proposal call it a revenue-raising measure. However, since all public employees will eventually be covered through normal employee turnover as a result of COBRA, the amount of revenue that this proposal would generate is solely short-term. In the long run, the federal government will be obliged to cover a far-greater number of beneficiaries than through the present system. When these effects are considered, the revenue raised by the proposal is much smaller than that suggested by the President.

For these reasons, the Municipality of Anchorage strongly urges the Committee to oppose the inclusion of the proposal to extend Medicare coverage in the FY88 budget. If I can be of any assistance to you as you continue budget deliberations, I am at your disposal.

Sincerely,

Tony Knowles

Tony Knowles
Mayor

ANCHORAGE POLICE DEPARTMENT
4501 SOUTH BRAGAW STREET • ANCHORAGE, ALASKA 99507-1599
TELEPHONE (907) 786-8500

TONY KNOWLES
MAYOR

RONALD L OTTE
CHIEF

July 16, 1987

The Honorable Dan Rostenkowski
Chairman
House Ways and Means Committee
1102 Longworth H.O.B.
Washington, D. C. 20515

Dear Chairman Rostenkowski,

I must express strong opposition to any proposal that would extend mandatory medicare to those employees currently exempt from coverage of Consolidated Omnibus Budget Reconciliation Act of 1985.

Such a proposal would have a severe impact upon the already devastated economy of both the State of Alaska and the Municipality of Anchorage. Though lucky enough to still be employed as government employees, many of us simply could not afford yet another decrease in "take-home" pay.

I respectfully urge that the present law, PL 99-272, the consolidated Omnibus Budget Reconciliation Act of 1985 be preserved as enacted.

Sincerely,

Ronald L. Otte
Chief of Police

RLO:vka

Congress of the United States
Washington, DC 20515

June 25, 1987

The Honorable Dan Rostenkowski
Chairman
House Ways and Means Committee
1102 Longworth H.O.B.
Washington, D. C.

Dear Mr. Chairman:

The undersigned wish to express our strong opposition to any proposal that would extend mandatory Medicare coverage to those state and local public employees who are currently exempt from the system.

Such a change would have a severe fiscal impact on already troubled state and local governments. Congress has twice rejected the idea, the last time during the consideration of the Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA). As you well know, an agreement was reached in COBRA which phases in the mandatory coverage by extending it to new hires.

It is appropriate that state and local governments be given time to plan and prepare for additional expenses mandated by the Federal government. The phase-in approach wisely provides that flexibility.

We respectfully urge that the compromise phase in of mandatory coverage for state and local government employees be preserved.

Sincerely,

Brian Donnelly
Hon. Brian Donnelly

Don J. Pease
Hon. Don J. Pease

Hank Brown
Hon. Hank Brown

Marty Russo
Hon. Marty Russo

Barbara B. Kennelly
Hon. Barbara B. Kennelly

Robert J. Matsui
Hon. Robert J. Matsui

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Hon. Billy Tauzin

Barbara F. Vucanovich
Hon. Barbara Vucanovich

Joel Hefley
Hon. Joel Hefley

Don Ritter
Hon. Don Ritter

Manuel Lujan
Hon. Manuel Lujan, Jr.

E de la Garza
Hon. E. de la Garza

Hon. Robert Smith

Hon. Nicholas Mavroules

Joe Kennedy
Hon. Joe Kennedy, II

Michael G. Andrews
Hon. Michael Andrews

Bob Borski
Hon. Bob Borski

David Dreier
Hon. David Dreier

Don Edwards
Hon. Don Edwards

John Kasich
Hon. John Kasich

Steve Bartlett
Hon. Steve Bartlett

Carlos J. Moorhead
Hon. Carlos Moorhead

Ken Gray
Hon. Ken Gray

Hon. Charles Hayes

Geo. W. Crockett
Hon. George W. Crockett

Mervyn M. Dymally
Hon. Mervyn Dymally

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June 25, 1987

James J. Howard
Hon. James J. Howard

Hon. Robert Lagomarsino

Bruce F. Vento
Hon. Bruce Vento

Silvio Conte
Hon. Silvio Conte

Joseph D Early
Hon. Joseph D. Early

Olympia Snowe
Hon. Olympia Snowe

Hon. J. Dennis Hastert

Julian C Dixon
Hon. Julian Dixon

Marcy Kaptur
Hon. Marcy Kaptur

Dan Schaefer
Hon. Dan Schaefer

Hon. Tom Sawyer

Hon. James H. Bilbray

Esteban E Torres
Hon. Esteban Torres

Ben Nighthorse Campbell
Hon. Ben Nighthorse Campbell

Edward Feighan
Hon. Edward Feighan

Hon. Michael Oxley

Barney Frank
Hon. Barney Frank

Hon. Matthew Martinez

Beau Boulter
Hon. Beau Boulter

Joe Moakley
Hon. Joe Moakley

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June 25, 1987

HON. DOUGLAS APPLEGATE

Bob McEwen
HON. BOB McEWEN

Tom Luken
HON. TOM LUKEN

Elton Gallegly
HON. ELTON GALLEGLY

Tony P. Hall
HON. TONY HALL

Marvin Leath
HON. MARVIN LEATH

HON. JAMES TRAFICANT

Lane Evans
HON. LANE EVANS

HON. MICHAEL DEWINE

HON. RON PACKARD

Jack Fields
HON. JACK FIELDS

Mel Levine
HON. MEL LEVINE

Howard L. Berman
HON. HOWARD BERMAN

Buddy Roemer
HON. BUDDY ROEMER

HON. DENNIS ECKART

Gus Savage
HON. GUS SAVAGE

Jack Davis
HON. JACK DAVIS

HON. JOHN PORTER

Guy Vander Jagt
HON. GUY VANDER JAGT

Don Young
HON. DON YOUNG

Bill Gradison
Honorable Willis D. Gradison,Jr.

Honorable Donald Lukens

Honorable Ralph Regula

Henry J Hyde
Honorable Henry J. Hyde

Augustus F. Hawkins
Honorable Augustus Hawkins

Pat Williams
Honorable Pat Williams

John Conyers
Honorable John Conyers, Jr.

Honorable Delbert Latta

Frank Annunzio
Honorable Frank Annunzio

Terry L. Bruce
Honorable Terry L. Bruce

Dick Durbin
Honorable Richard Durbin

Honorable Charles Pashayan, Jr.

Mary Rose Oakar
Honorable Mary Rose Oakar

Honorable Newt Gingrich

Sam Gejdenson
Honorable Sam Gejdenson

Joe Barton
Honorable Joe Barton

Honorable James Hayes

Honorable Pat Schroeder

Honorable Louis Stokes

Phil Crane
Honorable Phil Crane

Edward P Boland
Hon. Edward Boland

Hon. Albert C. Bustamante

Richard H Baker
Hon. Richard Baker

Bob Dornan
Hon. Bob Dornan

Dennis M. Hertel
Hon. Dennis Hertel

Chet Atkins
Hon. Chet Atkins

Lynn Martin
Hon. Lynn Martin

Jaime B Fuster
Hon. Jaime B. Fuster

Larry Combest
Hon. Larry Combest

Ed Madigan
Hon. Ed. Madigan

Jim Bunning
Hon. Jim Bunning

Louis Stokes
Hon. Louis Stokes

Mickey Leland
Hon. Mickey Leland

Clarence Miller
Hon. Clarence Miller

David E Skaggs
Hon. David Skaggs

Hon. Chalmers Wylie

Hon. Helen Delich Bentley

Kweisi Mfume
Hon. Kweisi Mfume

William O. Lipinski
Hon. William O. Lipinski

Ed Markey
Hon. Ed Markey

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June 25, 1987

Hon. Cardis Collins

Hon. Steven Gunderson

Jerry Solomon
Hon. Jerry Solomon

Carroll Hubbard
Hon. Carroll Hubbard

Clyde C. Holloway
Hon. Clyde C. Holloway

Joseph E. Brennan
Hon. Joseph E. Brennan

Jerry Huckaby
Hon. Jerry Huckaby

Earl Hutto
Hon. Earl Hutto

Edward R. Roybal
Hon. Edward R. Roybal

Barbara Boxer
Hon. Barbara Boxer

BL Livingston
Hon. Bob Livingston

Mac Sweeney
Hon. Mac Sweeney

Hon. Ben Gilman

Hon. James M. Inhofe

Jerry Lewis
Hon. Jerry Lewis

Tom Lantos
Hon. Tom Lantos

George E. Brown, Jr.
Hon. George E. Brown, Jr.

Hon. John Bryant

Nancy Pelosi
Hon. Nancy Pelosi

Glenn M. Anderson
Hon. Glenn M. Anderson

Connie Mack
Hon. Connie Mack

Dick Armey
Hon. Dick Armey

Hon. Howard C. Nielson

Martin Frost
Hon. Martin Frost

Jack Brooks
Hon. Jack Brooks

Jim Chapman
Hon. Jim Chapman

Ralph M. Hall
Hon. Ralph M. Hall

Chris Smith
Hon. Chris. Smith

Hon. Thomas J. Manton

Hon. Robert Badham

Hon. Gerry Studds

John G. Rowland
Hon. John G. Rowland

Hon. Melvin Price

Daniel K. Akaka
Hon. Daniel Akaka

Major R Owens
Hon. Major R. Owens

Lamar Smith
Hon. Lamar Smith

Robert C. Smith
Hon. Robert C. Smith

Hon. Ronald Coleman

Hon. Charles Wilson

The Honorable Dan Rostenkowski
Chairman
House Ways and Means Committee
1102 Longworth H.O.B.
Washington, D.C. 20515

Dear Mr. Chairman,

I must express strong opposition to any proposal that would extend mandatory medicare to those employees currently exempt from coverage of Consolidated Omnibus Budget Reconciliation Act of 1985.

Such a proposal would have a severe impact upon the already devastated economy of both the State of Alaska and the Municipality of Anchorage. Though lucky enough to still be employed as government employees, many of us simply could not afford yet another decrease in "take-home" pay.

I respectfully urge that the present law, PL 99-272, the Consolidated Omnibus Budget Reconciliation Act of 1985 be preserved as enacted.

Sincerely,

VINCE BANCROFT

OFFICER V. BANCROFT
ANCHORAGE POLICE DEPT
4501 S. BRAGAW
ANCHORAGE AK
99511

Identical letters were submitted by the following:

Mr. William Gaither, Anchorage, Alaska
Mr. Robert L. Hall, Jr., Eagle River, Alaska
Mr. Walt Monegan, Chugiak, Alaska
Mr. Thomas A. Morris, Anchorage, Alaska
Mr. David W. Rochford, Eagle River, Alaska
Mr. Stephen M. Russell, Anchorage, Alaska

June 24, 1987

Honorable Dan Rostenkowski
Chairman
House Ways and Means Committee
1102 Longworth H.O.B.
Washington, D.C. 20510

Dear Mr. Chairman:

The City of Beaumont wishes to express our strong opposition to any proposal that would extend mandatory Medicare coverage to all state and local government employees.

This proposal, which would have a severe fiscal impact on already troubled state and local governments, has been twice rejected by Congress. Texas communities have been struggling with hard economic times. Now is not the time to impose additional financial costs on cities. For the City of Beaumont, this would cost us over $165,000. From Washington, this may seem quite small, but for the taxpayers in Beaumont who are struggling everyday to find or keep a job, this is substantial.

We respectfully urge that the compromise phase-in enacted in the Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA) be preserved.

Very truly yours,

Maurice Meyers

Maurice Meyers
Mayor

MM/ej

cc: Senator Phil Gramm
Congressman Jack Brooks

cde

Colorado Department of Education

State Office Building
201 E. Colfax Avenue
Denver, CO 80203

Calvin M. Frazier
Commissioner of Education

August 27, 1987

The Honorable Dan Rostenkowski
Chairman
House Ways and Means Committee
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Senator Rostenkowski:

The Colorado Federal Relations Commission (CFRC) is still very much concerned about Congress changing the Medicare law to mandatory coverage for all public employees. This would create havoc in our school districts with additional financial outlays in a time of severe economic problems in Colorado, plus seriously impact our present P.E.R.A. system. As a result, the CFRC adopted the attached resolution at its August 21 meeting. A fact sheet is also attached to the resolution for your review.

If you have any questions or comments, we will be pleased to discuss this with you during our September 17-18 visit in Washington.

Sincerely,

Arvin C. Blome
Assistant Commissioner

attachments

ACB/bcb

Colorado Federal Relations Commission

Medicare Resolution

WHEREAS, the Administration has proposed in its 1988 Budget to mandate Medicare coverage to all public employees hired prior to April 1, 1986; and

WHEREAS, the Colorado Federal Relations Commission for Education has found that mandatroy coverage would create a significant fiscal burden for both state/local governments and their employees, which would adversely affect the quality of the services they provide; and

WHEREAS, State and local governments require a reasonable time period to plan and prepare for the additional expenses mandated by Public Law 99-272; and

WHEREAS, State and local governments should maintain control of the legally established retirement plans for their employees hired prior to April 1, 1986; and

WHEREAS, the revenue generated by the mandatory coverage of all state/local government employees would provide a short term gain at the expense of a mid- and long-term loss to the Federal Government; and

WHEREAS, noncovered employees do pay their fair share for Medicare covereage when reaching 65 and opting for coverage; therefore be it

RESOLVED, that the Colorado Federal Relations Commission for Education requests the provisions of (COBRA) P.L. 99-272 which limits mandatory Medicare coverage to state/local government employees hired after March 31, 1986 be preserved, thus allowing noncovered workers to maintain their current employment and retirement benefits.

Adopted August 21, 1987

MEDICARE FACTS

- When Social Security was established (1935), state/local government employees were prohibited from joining. In response those entities developed their own health/retirement plans.

- 1950 amendments to the Social Security Act permitted state/local governments to opt into Social Security.

- In 1965, Medicare was enacted. Parts A and B were automatically extended to all government employees participating. (Part A = Hospitalization Insurance - Part B = Medical Care)

- Until 1983, state/local governments could terminate coverage if they had been covered for at least five years and gave the government two years' notice. Amendments passed in 1983 repealed this provision of the law.

- With passage of Consolidated Omnibus Budget Reconciliation Act of 1985 (COBRA) Public Law 99-272, part A and B coverage became mandatory for workers hired by state/local governments after April 1, 1986. 1.45% Medicare Tax to be paid by both employee and employer. This act provided for the phasing in of employees to be covered by Medicare.

- The Omnibus Budget Reconciliation Act of 1986 (OBRA) attempted to mandate Medicare coverage for all employees, but the Senate/House Conference Committee failed to reach agreement. OBRA maintained COBRA's phase-in process.

- The administration's budget included a provision to mandate Medicare coverage for all state/local government employees effective January 1, 1988. 71% (10.1 million) of all state/local government employees nationwide (14.2 million) are presently covered.

- Revenues generated by administration proposal:
  ($ In Billions)

1988	1989	1990	1991	1992	Cumulative
1.3	1.9	1.9	2.0	2.1	*9.3

* Reflects 25% of the $36 billion new revenues proposed by the administration for the time period FY '87-'92.

- Cost to Colorado for mandatory coverage:

  1) $50 million total for employers/employees.

  2) Average salary of a Colorado State employee $23,676. Medicare Tax would be $343 (1.45%).

- Arguments for administration proposal:

  1) 94% of recipients of state/local pensions age 65 and older are eligible for Medicare due to other employment or spousal eligibility.

  2) The benefits of Medicare coverage should be extended to all state/local governments.

- Arguments against administration proposal:

  1) Significant fiscal burden would be imposed on state/local governments and their employees.

  2) COBRA phases in coverage. By 2005, 99% of state/local employees will be included.

  3) Tenth Amendment allows states certain governance rights, in this case the right to structure retirement benefits for employees hired prior to 4/1/86.

  4) Mandatory coverage would provide short term revenue increase at the expense of increased program costs associated with increased demands for benefits.

- Current eligibility process:

  1) Individual paying into Medicare upon reaching age 65 would be:

     a) Eligible for Part A (Hospitalization) at no charge

     b) Eligible for Part B (Medical Care) for a premium of $17.90 a month

  2) Individual who has not paid into Medicare upon reaching age 65 would be:

     a) Eligible for Part A for a premium of $226.00 a month

     b) Eligible for Part B for a premium of $17.90 a month

  3) Individual who has not paid into Medicare upon reaching age 65 with a Medicare eligible spouse who is at least age 62 would be:

     a) Eligible for Part A at no charge

     b) Eligible for Part B at $17.90 a month premium

School District Number Twenty

Administration Office
Phone 303-598-2566

7610 NORTH UNION BOULEVARD • COLORADO SPRINGS, CO 80918
Thomas S. Crawford, Superintendent of Schools

August 31, 1987

The Honorable Dan Rostenkowski
US House of Representatives
2111 Rayburn House Office Building
Washington, DC 20515-1308

Dear Representative Rostenkowski:

I am writing to you regarding the Administration's proposal to extend Medicare coverage to all state and local government employees not currently participating in the program. After reviewing the proposal, it appears the proposal is merely an attempt to boost revenues for a short-term fix which will in reality increase the demands for benefits and cost the federal government more money in the long run.

There are four reasons why I am asking you to oppose the mandatory coverage for all employees:

1) It would cost the taxpayers of Colorado $50 million at a time when all governmental entities and individuals are struggling with a poor economic situation and limited fiscal resources. The cost specific to Academy District Twenty and its employees would be approximately $575,000.

2) P.L. 99-272 (COBRA) will insure that by the year 2005, 99 percent of all state/local government employees are covered by Medicare.

3) Colorado's PERA has provided health care and hospitalization insurance options for its participants which are comparable to Medicare.

4) Those individuals who have not paid into Medicare but who elect to participate upon reaching age 65 pay their fair share through monthly premiums; there is no free ride.

I would ask that as Congress addresses the issue of mandatory Medicare coverage that you work to maintain the phase-in concept that is contained in P.L. 99-272, thus allowing noncovered workers to maintain their current employment and retirement benefits. Mandatory coverage of all employees would create a significant fiscal burden for the citizens of Colorado.

Thank you for your attention to this matter.

Sincerely,

Steven J. Pratt

Steven J. Pratt
Director of Governmental Programs

COLUSA RURAL
FIRE PROTECTION DISTRICT

235 Market Street
Colusa, California 95932
916-458-8239

August 24, 1987

The Honorable Dan Rostankowski, Chairman
House Ways and Means Committee
1102 Longworth H.O.B.
Washington, D.C.

Dear Mr. Rostankowski, Chairman House Ways and Means Committee;

I wish to express my strong opposition to any proposal during the reconciliation process which would extend mandatory Medicare Coverage to those State and Local Public Employees who are currently exempt from the system.

Such a change would have a severe fiscal impact on already financially strapped local governments. California has 848,000 employees who are not covered by the Medicare System. Thus, if this proposal is signed into law, the combined annual cost to California and its local governments is estimated at $330.5 Million. The impact of this new mandate in the State of California, coupled with the loss of General Revenue Sharing and local governments' inability to raise new revenues, will inevitably result in the reduction or elimination of vital governmental services.

Congress has twice rejected the idea of extending coverage to all State and local employees, and a compromise with finally reached last year in which mandatory coverage was extended to employees hired after March 31, 1986.

It is appropriate that State and Local Governments be given time to plan and prepare for additional expenses mandated by the Federal Government. Thus, the phase-in approach enacted last year should be preserved.

Very Truly Yours,

Jeffrey S. Winters
Jeffrey S. Winters
Fire Chief

Similar letters were submitted by the following:

Forestville Fire Protection District, Mr. Gary F. Duignan, Chief, Forestville, California
Murrieta Fire Protection District, Mr. Marvin D. Curran, Chief, Murrieta, California
North Central Fire Protection District, Mr. William L. Burgen, Fire Chief, Kerman, California
Novato Fire Protection District, Mr. James Berthinier, Fire Chief, Novato, California
San Bernardino County Fire Agency, Mr. Jim Lawrence, Fire Chief, Fontana, California
San Marcos Fire Protection District, Mr. Harry T. Townsend, Chief of Department, San Marcos, California

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County Manager
(702) 782-9821

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Barbara J. Cook
Vice-Chairman
Robert L. Pruett
R.A. Oswald
Michael E. Fischer

July 9, 1987

The Honorable Dan Rostenkowski
U.S. House of Representatives
2111 Rayburn House Office Bldg.
Washington, D.C. 20001

Dear Mr. Rostenkowski:

I want to express my deep concern over the possibility of the medicare payroll tax being extended to apply to all public employees. While 1.45% of a $30,000.00 a year salary does not appear to constitute a hardship on the employee, I am asking you to consider the employee who earns minimum wage or slightly above, who is also a single parent with a child or children to support. Any reduction in this employee's salary does constitute a hardship.

I also appeal to you on behalf of local government as an employer. In this time of dwindling or static revenues and increasing demands for additional services, local government has had to re-evaluate all our programs and has worked hard to use our resources for the greatest good. 1.45% of our salaries would be approximately $63,654.00. In an organization the size of ours this means the loss of three employees or the reduction and possible termination of a vital program.

These are just two of my concerns. However, they are important because of the adverse impact of an additional reduction in funds. I ask you to please give consideration to the concerns of state and local governments before making a decision on whether or not to extend the application of medicare payroll tax.

Sincerely,

Jerry J Bing

Jerry J. Bing
Chairman

JJB/sjp

Courthouse • P.O. Box 218 • Minden, Nevada 89423

County of El Dorado

BOARD OF SUPERVISORS

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BILLIE MITCHELL........................COUNTY CLERK

330 Fair Lane • Placerville, CA 95667
Telephone (916) 626-2464

July 16, 1987

The House Ways and Means Committee
Longworth House Office Building -Rm 1102
Washington, D.C. 20515

Gentlemen:

At a regular meeting of the El Dorado County Board of Supervisors held Tuesday, June 30, 1987, the Board approved the request of Executive Director, John P. Thomas, National Association of Counties urging immediate action by elected officials in affected counties in contacting the House Ways and Means and Senate Finance Committees to register opposition to any amendments that would extend the Medicare Payroll Tax to all state and local employees.

Furthermore, the Board directed that the County's employees' associations be asked to join in the effort by also forwarding letters of opposition to said Committees.

Very truly yours,

JAMES R. SWEENEY, Chairman
Board of Supervisors

BILLIE MITCHELL, County Clerk
& ex-officio Clerk of the Board

By Margaret E. Baca
Deputy Clerk

/meb

cc: El Dorado County Employees' Association, w/att
Operating Engineers Local Union No. 3, w/att
El Dorado County Sheriff's Association, w/att

CITY OF FOUNTAIN VALLEY
CITY HALL, 10200 SLATER AVENUE, FOUNTAIN VALLEY, CA 92708
FROM THE OFFICE OF THE MAYOR (714) 965-4400

August 3, 1987

Congressman Dan Rostenkowski, Chairman
HOUSE WAYS AND MEANS COMMITTEE
House Office Building
Washington, D. C. 20515

RE: H.Con.Res.93 - Mandatory Medicare Coverage for Municipalities - OPPOSE

Dear Committee Chairman:

The City of Fountain Valley is opposed to medicare coverage which would require all municipalities and their employees to contribute 1.45% of salary to the medicare system. The City of Fountain Valley would experience an increased cost of $124,700 should this mandatory coverage be required for existing employees.

The City of Fountain Valley provides health insurance coverage for retirees under our existing labor agreements. To double this burden to make the local government employees subject to medicare costs is not in the best interests of the city nor its residents. We believe that with proper management techniques, the medicare system should be able to rectify any inadequacies in their system without the influx of revenue from local government employees. This is a short term solution to put money into the system but future costs will exceed the benefits.

The City of Fountain Valley looks forward to your opposition to mandatory medicare coverage for municipalities when it is heard before your House Ways and Means Committee.

Very truly yours,

Barbara Brown

Barbara Brown
Mayor

AUG 7 1987
WAYS AND MEANS

BB:DLH:bjs

CC: Congressman Badham

INTERNATIONAL ASSOCIATION OF FIRE FIGHTERS
1750 NEW YORK AVENUE, N.W., WASHINGTON, D.C. 20006
TELEPHONE NO. (202) 737-8484

John A. Gannon
President

Alfred K. Whitehead
Secretary-Treasurer

August 12, 1987

The Honorable Dan Rostenkowski
Chairman, Ways and Means Committee
United States House of Representatives
Washington, D.C. 20515

Dear Representative Rostenkowski:

Next month, the House Ways & Means Committee is scheduled to complete action on the revenue provisions of the budget reconciliation bill. In this context, we expect consideration to be given to enactment of a provision mandating Medicare coverage for all currently uncovered employees of state and local governmentss.

I am writing on behalf of the International Association of Fire Fighters and its 170,000 members nationwide to express our strong opposition to any proposal to expand mandatory Medicare coverage to currently uncovered employees of state and local governments.

This issue has been debated at length and was decided when Congress enacted the 1985 Consolidated Omnibus Budget Reconciliation Act (COBRA). The COBRA contained a compromise provision which mandated coverage for all newly hired employees of state and local governments after March 31, 1986. This compromise provision allowed for a gradual transition and notice of impending financial obligations to both employers and newly hired employees. The IAFF believes that it would be a breach of faith with our 170,000 members for Congress to now renege on this compromise, and mandate coverage for all currently employed workers. It seems abundantly clear that this provision is again under consideration as a short-sighted plan for revenue raising rather than as a result of balanced consideration of public policy.

If enacted, a mandatory coverage proposal will increase the tax burden of these middle income public employees and jeopardize health benefits provided under long established retirement plans.

For years, state and local government employees were specifically excluded from the Medicare system. As a result, our members have spent years in a successful effort to establish independent retirement systems which include health benefits. These retirement plans are structured to meet the special needs of public safety employees. Fire fighting is one of the most hazardous occupations in the world. Many of our members retire between the ages of 50 and 55 and by that age have contracted cancer and/or heart disease at twice the rate of the general population. Our members need retirement health benefits which will commence at an earlier age than Medicare. For this reason, they will have the burden of continuing to participate in, and pay the premium for, private retirement health coverage in addition to the Medicare tax.

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125

Therefore, enacting a mandatory coverage proposal will disrupt these long established retirement health plans and jeopardize future health benefits for our members, while imposing a heavy financial burden on these middle income employees.

The IAFF is troubled by the deceptive and inaccurate argument advanced by proponents in support of the mandatory coverage proposal-- that the proposal is "fair" because a majority of state and local employees receive Medicare benefits having paid little or nothing into the system. The implication of this argument-- that state and local employees have been receiving a "free ride" with respect to Medicare benefits-- is not only inaccurate but is unfair to public employees and the general public. The IAFF represents 170,000 dedicated fire fighters who risk their lives daily in communities all across the nation. These fire fighters do not receive a "free ride" with respect to any health benefits, including Medicare.

First, state and local employees become eligible for Medicare benefits in precisely the same way every other American becomes eligible-- either by working the required minimum number of quarters in private sector employment (in addition to their public sector employment) and/or by qualifying as a result of their spouse's covered employment. Despite their employment in the most dangerous occupation in the world, fire fighters support families on an average income of approximately $18,500 per year. Therefore, many of our members work second, private sector jobs to supplement their income and pay Medicare taxes on that income. In addition, our members are employed for significant periods of time in private sector employment before entering the fire fighting occupation and after retiring and, again, pay Medicare taxes on that income.

Second, to the extent this perceived inequity exists, it was corrected by a provision of the 1985 budget reconciliation act (COBRA) which mandated Medicare coverage for all state and local government employees after March 31, 1986. This provision allows for a gradual transition and all employees will be covered in approximately ten years.

Implementation of this policy would contradict an important and frequently stated goal of both Congress and the Reagan Admininstration.

Mandatory coverage would require the imposition of a new tax on middle income workers; the amount of this tax would exceed the average tax cut provided to middle income workers by the recently enacted tax reform bill. This is in direct contradiction to Congress' and the Administration's frequently cited policy goal of providing tax relief to this sector of the public.

This proposal has been thoroughly debated and twice rejected by Congress. I urge you to abandon this proposal and seek other avenues for generating revenue.

Sincerely,

Harold A. Schaitberger

Harold A. Schaitberger
Director
Department of Governmental Affairs
and Public Relations

MONTGOMERY COUNTY

MONTGOMERY COUNTY ADMINISTRATION BUILDING
451 WEST THIRD STREET
DAYTON, OHIO 45422-1110

COUNTY COMMISSIONERS
Charles J. Curran
Paula J. MacIlwaine
Donna B. Moon

COUNTY ADMINISTRATOR
Claude D. Malone, Jr.

June 26, 1987

The Honorable Dan Rostenkowski, Chairman
House Ways and Means Committee
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

As local elected officials we want to again express our strong opposition to the extention of the medicare payroll tax to all state and local employees.

The increased cost to Montgomery County would be one million dollars a year. This is a significant financial burden, which will not be easily absorbed without dramatic cutbacks in other areas. We've already lost revenue sharing and feel that strain.

State and local governments have increasingly been forced to shoulder major responsibility for reducing the federal deficit. We are opposed to using mandatory state and local medicare contributions to reduce the federal deficit.

Sincerely,

BOARD OF COUNTY COMMISSIONERS
MONTGOMERY COUNTY, OHIO

Charles J Curran
Charles J. Curran, President

Paula J. MacIlwaine

Donna B Moon
Donna B. Moon

BCC:DAF:esa

NATIONAL ASSOCIATION OF POLICE ORGANIZATIONS, INC.
1899 L Street, N.W., Suite 800 • Washington, D.C. 20036 • (202) 466-6790

Statement of

Robert Scully, President,
National Association of Police Organizations
to the House Ways and Means Committee

July 14, 1987

My name is Robert Scully. I serve as President of the National Association of Police Organizations, (NAPO), an organization which represents more than 60,000 working and retired police officers throughout the United States. I am a working police officer on leave from the City of Detroit Police Department. I also serve as Vice President of the Detroit Police Officers Association.

I am writing to express the opposition of our organization and its membership to the Administration's proposal for the fiscal year 1988 budget, which includes a provision to expand Medicare coverage to all state, county and municipal employees not presently covered. The object of this proposal is to generate approximately $7.1 billion in new federal revenue over a four-year period through the imposition of payroll taxes of 1.45% on gross wages of newly-covered employees and their employers. Our organization is firmly opposed to such new taxes. The reason for our position is that for years state and local government employees have been specifically excluded from participation in Medicare. Indeed, substantial efforts have been made in the past to create sound and secure public employee retirement and health benefit systems for state and local government employees. We believe that mandatory Medicare coverage would undermine these programs, subject them to financial risk, and unfairly penalize current government employees all in the interest of raising additional federal revenue.

In addition, the increased cost to state and local governments for such coverage for public employees will result in substantial cuts in essential government services in many communities around the nation.

Further, this proposal comes at a time when states are trying to cope with the Administration's "new federalism" which has resulted in the shift to the states of responsibility for many previously federal programs. A mandatory Medicare tax would undoubtedly undermine the states' ability to afford to finance such programs.

We further believe that the idea of this mandatory coverage is in conflict with two expressly stated policies of the Reagan Administration. First, the proposal will succeed in imposing a new tax on public employees, which would exceed whatever tax savings they received under the Tax Reform Act of 1986.

Secondly, the proposal would seriously infringe upon the right of local governments to structure the fringe benefits packages of state employees -- an area

Office of the President
Detroit Police Officers Association • 6525 Lincoln • Detroit, MI 48202 • (313) 871-0484

which historically has been regarded as being within the exclusive province of local government.

We recognize that this proposal does not affect all of the members of NAPO, but it is at the same time a major priority for those large number of members who are not currently paying the Medicare tax.

Therefore, we seriously urge that the members of this Committee vote against the proposed mandatory medical tax, both in Committee and in the House and the Senate.

# # #

DR. ROBERT P. RODEN
525 SEVENTH STREET, N.E.

SUPERINTENDENT OF SCHOOLS
NORTH CANTON, OHIO 44720

August 21, 1987

House Ways and Means Chairman
Congressman Dan Rostenkowski
2111 Rayburn Building
Washington, D.C. 20515

Dear Congressman Rostenkowski:

In reviewing a list of revenue raising options, I am particularly concerned about extending medicare payroll tax to all state and local government employees. We estimate that this proposal will cost our school district $130,000 per year, if it is implemented. For the second half of this school year we will miraculously have to come up with $65,000 which was not in our original appropriations measure.

Please consider very carefully the plight of Ohio school districts who are already facing decreased budgets and high expectations.

Sincere thanks for your attention to this matter.

Sincerely,

Dr. Robert P. Roden
RR:sr

OUR CHILDREN... OUR FUTURE... OUR BEST!

OPPOSE

1300 LOGAN STREET DENVER, CO 80203
Telephone (303) 832-9550

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Mary Fox
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Robert J. Scott
Secretary, Treasurer

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Association
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Civil Employees Inc
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Association
Nevada Public Employees
Retirement System
Ohio Education Association
Teachers Retirement
System of Illinois
United Teachers
Los Angeles

STATEMENT OF ROBERT J. SCOTT

ON BEHALF OF

ORGANIZATION FOR THE PRESERVATION OF THE PUBLIC EMPLOYEES' RETIREMENT INDUSTRY AND OPPOSITION TO SOCIAL SECURITY EXPANSION TO SUCH INDUSTRY

(OPPOSE)

Before the House Committee on Ways and Means

Hearing on Revenue Increases

July 7, 1987

Before the House Committee on Ways and Means

Hearing on Revenue Increases

July 7, 1987

Members of the House Committee on Ways and Means, I am Robert J. Scott, secretary-treasurer of OPPOSE. OPPOSE is a Colorado corporation formed by teachers, firefighters, police, and other state and local government employees who have elected not to join the Social Security system. The purpose of our organization is to assure the continued financial integrity of our members' retirement and health insurance plans by resisting congressional efforts to mandate Social Security or Medicare coverage of public employees. Our members are found in Alaska, California, Colorado, Illinois, Louisiana, Massachusetts, Nevada, and Ohio. With respect to the issue of mandatory Medicare coverage, the interests of OPPOSE are identical to those of the four to five million public employees throughout the nation who remain outside the Social Security system.

Through this testimony, we wish to express our strong opposition to the proposal in the Administration's budget to impose Medicare coverage upon all state and local government employees effective January 1, 1988.

By way of background, I would remind you that employees of state and local government were not permitted to join the Social Security system when it was established in 1935. While they have been permitted to join since the 1950s, those who have chosen to remain outside the system have their own retirement plans and, in many instances, health insurance plans.

In response to the federal government's pressing need for revenues, Congress, in the Consolidated Omnibus Budget Reconciliation Act of 1985 ("COBRA"), determined to require public employers and their employees to pay the Medicare tax. It implemented this decision by extending mandatory Medicare coverage to all state and local government employees hired on or after April 1, 1986. Through adoption of this phase-in provision, which will result in Medicare coverage of all public employees through normal job turnover, Congress assured itself that all public employees will ultimately pay the full Medicare tax to the federal government. The individuals excluded from coverage under COBRA were those who were already working and for whom the Medicare tax would both constitute a pay cut and jeopardize their existing health benefits. While we at OPPOSE did not favor mandatory Medicare coverage, we believed that the phase-in provision adopted in COBRA was a reasonable, permanent solution that avoided imposing overwhelming burdens on state and local governments and their employees.

Last year, during consideration of the Omnibus Budget Reconciliation Act of 1986, Congress threatened to abandon COBRA's phase-in by mandating coverage of those employees specifically excluded from coverage under COBRA, but, in the end, did not adopt such a provision.

We believe that the phase-in compromise reached in COBRA should be respected and that our employees and retirees should not be visited by the same threat year in and year out. Therefore, and for the reasons set forth below, OPPOSE asks you this year once and for all to reject the proposal to extend mandatory Medicare coverage to all state and local government employees.

1. Despite the promises of the President not to raise taxes and the avowed intentions of many legislators to provide a tax cut to the middle class, this proposal targets four to five million lower-middle-class Americans and their spouses for a tax increase that would more than offset the tax cut that they will receive as a result of the Tax Reform Act of 1986. According to estimates of the Joint Committee on Taxation, the Tax Reform Act would provide taxpayers with incomes in the range of $20,000 - $30,000 with a cut equivalent on the average to $220. The new Medicare tax that would be imposed upon state and local government employees equals 1.45% of payroll. Thus, in the case of the average government employee in Colorado (whose annual salary is $23,676), the new Medicare tax of $343 would result in a net tax increase of $123. If the Colorado government passes its equivalent new tax along to its employees, the employee's tax increase could double.

2. Mandatory Medicare coverage would impose a heavy fiscal burden upon state and local governments, who are already operating with very limited resources. While the impact of the proposal would fall most heavily upon governments in approximately ten states, almost every state includes some subdivisions with non-covered employees that would be significantly harmed by these additional operating costs. (See attached table.) We would point out that the proposal would cost governments in Illinois $100 million in the first year; governments in Texas, $162 million; governments in California, $331 million; governments in Colorado, $50 million; and governments in Ohio, $200 million.

Imposition of these additional costs would come at a particularly trying time. State and local governments have repeatedly been forced to shoulder additional burdens in recent years, resulting from considerable cuts in the federal appropriations for many of their programs and the loss of revenue-sharing, while the Tax Reform Act limited their ability to raise revenues, through loss of the sales tax deduction and new restrictions upon municipal bonds.

As a result, state and local governments (many of which operate under balanced budget restrictions) are simply unable to absorb additional fiscal burdens. Many local governments must already raise taxes to maintain existing public service spending levels formerly funded through revenue-sharing. A recent study by the National League of Cities concluded that general fund revenues will decline this year for one-third of the cities and towns throughout the United States.

3. Mandatory Medicare coverage would have a pointedly adverse impact upon education. It is well recognized that one of the causes of the current state of our public education system is the extreme difficulty school systems face in

recruiting and retaining quality teachers. It has been reported that half of the nation's public school teachers will cease to teach over the next six years and that the country will have 34% fewer teachers than it needs by 1992.

One reason for this problem is that teachers are vastly underpaid. In 1985-1986 the average teacher's salary was $25,000, while the averages ranged state-by-state between $18,000 and $41,000. In constant dollars, the average American schoolteacher's salary has risen only 2.87% over the last ten years. The constant-dollar increase has been even less in several of the states that would be most heavily affected by mandatory coverage. In four of those states (California, Illinois, Louisiana, and Maine) the average teacher's salary has actually declined in constant-dollar terms.

Medicare coverage would only make the teacher recruitment problem worse. Teaching is one of the major professions with large numbers of non-covered employees. The 1.45 percent Medicare tax would take an additional $367 from the average teacher's salary each year. That amount could double if school systems attempt to recoup their own, equal Medicare tax obligations from their employees. Thus, it would become even more difficult to retain good teachers, and many of the most qualified teachers -- particularly those with marketable skills in mathematics, science, and computers -- would simply leave teaching for better paid employment.

4. The mandatory Medicare coverage proposal would create a host of problems that were avoided by the compromise position adopted in COBRA. As mentioned earlier, some state and local government employees have health plans in place for their employees, including retirees. Adjustment of these plans to take account of Medicare coverage for existing employees would prove an overwhelming task, or would result in abandonment of these plans. For example, Colorado's Public Employees' Retirement Association administers a health insurance plan for its members. Of the overall retirement contribution, 0.8 percent is earmarked for the health insurance fund. If the current mandatory Medicare coverage proposal were adopted, the Colorado legislature (which is already operating under strict budgetary constraints) could well decide to contribute less or none at all to the health insurance plan. Because the benefits of current retirees depend upon current and future contributions, their benefits would certainly be jeopardized. Moreover, as a result of this increased Medicare tax liability, the Colorado legislature might well decide it could not afford cost-of-living adjustments to the retirement benefits of its pensioners.

Unlike COBRA, the current proposal would have the effect of reducing the salary of existing workers, including long-term employees. This will cause difficulties both for employers and employees, particularly where salaries are carefully negotiated, for example, through the collective barganing process.

While COBRA affects the health benefits and take-home pay of individuals at the time they begin employment, the effect of the current proposal would be to supplant benefit programs that individuals have enjoyed, in some cases, for many years, and to reduce the amount of take-home pay they have come to expect.

5. The projected revenues for mandatory Medicare coverage are overstated in the Administration's budget and in the re-estimates performed by the Congressional Budget Office. The Administration's budget states that its mandatory Medicare coverage proposal would raise $1.6 billion in fiscal 1988 and $2.2 billion in each of the four following years, while CBO concluded that the proposal would raise $1.3 billion in 1988 and amounts rising from $1.9 billion in 1989 to $2.1 billion in 1992. In its description of revenue options, the staff of the Joint Committee on Taxation adopted the CBO's estimates for 1988-90. Since these estimates do not decline in the out-years, they apparently ignore the effect of the provision in COBRA that imposed mandatory Medicare coverage on all newly hired public employees. As result of that provision, the proportion of Medicare-covered employees in the public work force is increasing rapidly. In Colorado, which we believe to be a typical example, state and local government work forces turn over at a rate of approximately 9% annually. Thus 9% of the work force not covered before COBRA will already be covered by Medicare on April 1, 1987, and approximately 15% will be covered by January 1, 1988, the effective date of the current mandatory coverage proposal.

Revenues raised by coverage of these new employees have already been obtained by Congress in COBRA and presumably scored for budget purposes. Even if there is some job "turnover within the turnover" as new employees replace those hired after April 1, 1986, the revenues available in the the out-years must decline substantially, and ultimately decline to zero, as a result of the complete turnover of the work force. At best, the current mandatory Medicare coverage proposal would provide only "quick fix" deficit reduction and would do nothing to reduce the structural deficit.

Moreover, expansion of mandatory Medicare coverage would also entail offsetting costs to the Medicare system because the newly covered individuals will also become newly entitled to benefits. Some of these cost increases would occur in the very near term because if Congress extends the Medicare tax to all state and local government employees, it will probably provide benefits to those workers who are within five years of retirement (as it did for federal workers when it brought them into the system). While it is frequently asserted that requiring state and local government employees to participate in the Medicare system would be cost-free because the employee already receive Medicare benefits through other covered employment or through their spouses, the number of such employees has been the subject of some dispute and speculation. As a result, the additional costs to the federal government, which must be offset against revenues, may be understated. Given the short-run deficit that now faces the Medicare system, a proposal that involves potential and unpredictable short-term cost increases to the system seems poor policy. Of course, because they span only a few years, the revenue estimate in the President's budget and as re-estimated by CBO fail to reflect any of the long-term costs to the system resulting from the fact that a new class of workers would become entitled to benefits.

* * * * * *

For these reasons, we urge you once again and finally to reject the proposal to extend mandatory Medicare coverage to include all state and local government workers. Thank you for allowing me this opportunity to present the views of OPPOSE.

ANNUAL COST TO STATE AND LOCAL GOVERNMENTS OF MEDICARE COVERAGE OF ALL EMPLOYEES
(in millions of dollars) 1/

State	Number of public employees who are not covered by the Medicare/Social Security system 2/	Percentage of non-covered public employees 2/	Cost of coverage of all state and and local employees 3/
Alabama	27,000	11	9.0
Alaska	40,000	69	13.3
Arizona	21,000	11	7.0
Arkansas	39,000	13	13.0
California	991,000	63	330.5
Colorado	150,000	76	50.0
Connecticut	63,000	37	21.0
Delaware	14,000	34	4.7
Florida	127,000	21	42.3
Georgia	64,000	18	21.3
Hawaii	24,000	33	8.0
Idaho	0	0	0
Illinois	299,000	48	99.7
Indiana	54,000	17	18.0
Iowa	5,000	2	1.7
Kansas	2,000	1	.7
Kentucky	56,000	27	18.7
Louisiana	271,000	85	90.4
Maine	52,000	71	17.3
Maryland	29,000	10	9.7
Massachusetts	334,000	100	111.4
Michigan	19,000	4	6.3
Minnesota	96,000	33	32.0
Mississippi	2,000	1	.7
Missouri	62,000	22	20.7
Montana	5,000	9	1.7
Nebraska	2,000	2	.7
Nevada	49,000	94	16.3
New Hampshire	6,000	10	2.0
New Jersey	30,000	6	10.0
New Mexico	33,000	27	11.0
New York	153,000	12	51.0
North Carolina	43,000	11	14.3
North Dakota	6,000	10	2.0
Ohio	595,000	100	200.1
Oklahoma	33,000	15	11.0
Oregon	14,000	7	4.7
Pennsylvania	36,000	6	12.0
Rhode Island	25,000	43	8.3
South Carolina	6,000	3	2.0
South Dakota	2,000	5	.7
Tennessee	29,000	12	9.7
Texas	486,000	30	162.0
Utah	1,000	1	.3
Vermont	1,000	2	.3
Virginia	72,000	18	24.0
Washington	36,000	13	12.0
West Virginia	7,000	6	2.3
Wisconsin	48,000	16	16.0
Wyoming	5,000	10	1.7
TOTAL	4,546,000		$1,516.1

1/ These figures reflect only the 1.45% that must be paid by the governments as employers. For the impact of the proposal upon individual employers, who must also begin to pay the 1.45% Medicare tax, see the reverse side.

2/ Social Security Administration, 1985 Current Population Survey and Continuous Work History Sample, reprinted in Congressional Research Service paper "Medicare Coverage of Employees of State and Local Government," prepared at the request of the Subcommittee on Health of the House Committee on Ways and Means by David Koitz, Specialist in Social Legislation, Education and Public Welfare Division (March 11, 1987). Presumably included in these estimates are jobs now filled by employees hired after March 31, 1986, who participate in the Medicare syste as a result of the Consolidated Omnibus Budget Reconciliation Act of 1985, Pub. L. 99-272. These figures might therefore be reduced marginally to account for employee turnover (estimated to occur at a rate of approximately 9% annually) since March 31, 1986.

3/ Given that the employer's part of the 1987 Medicare tax is 1.45%, and assuming that the salary of the average state or local government employee is $23,000, each governmental employer's cost is equal to the number of employees, multiplied by 23,000, multiplied by 1.45%.

ANNUAL COST TO STATE AND LOCAL GOVERNMENT EMPLOYEES OF MEDICARE COVERAGE OF ALL EMPLOYEES

State	Annual salary of average public Employee 1/	Annual tax increase resulting from proposal 2/	Average tax decrease resulting from the Tax Reform Act 3/
Alabama	$19,272	$279	$200
Alaska	39,084	567	273
Arizona	24,996	362	220
Arkansas	17,796	258	200
California	30,084	436	273
Colorado	23,676	343	220
Connecticut	24,360	353	220
Delaware	22,884	332	220
Dist. of Columbia	33,288	483	273
Florida	20,556	298	220
Georgia	19,056	276	200
Hawaii	22,596	328	220
Idaho	18,832	273	200
Illinois	24,780	359	220
Indiana	22,560	327	220
Iowa	21,024	305	220
Kansas	20,124	292	220
Kentucky	19,248	279	200
Louisiana	19,080	277	200
Maine	18,444	267	200
Maryland	27,144	394	220
Massachusetts	23,976	348	220
Michigan	26,808	389	220
Minnesota	25,296	367	220
Mississippi	16,116	234	200
Missouri	20,244	294	220
Montana	22,284	323	220
Nebraska	18,588	270	200
Nevada	23,676	343	220
New Hampshire	19,308	280	200
New Jersey	24,192	351	220
New Mexico	19,608	284	200
New York	26,220	380	220
North Carolina	19,956	289	200
North Dakota	21,984	319	220
Ohio	21,492	312	220
Oklahoma	18,816	273	200
Oregon	22,632	328	220
Pennsylvania	22,068	320	220
Rhode Island	24,204	351	220
South Carolina	18,120	263	200
South Dakota	17,232	250	200
Tennessee	18,588	270	200
Texas	20,676	300	220
Utah	21,528	312	220
Vermont	19,248	279	200
Virginia	20,652	299	220
Washington	24,504	355	220
West Virginia	17,940	260	200
Wisconsin	23,148	336	220
Wyoming	22,404	325	220

1/ U.S. Bureau of the Census, Public Employment in 1985 - Government Employment (Series GE85-No.1) at 8.

2/ The amount of the new Medicare tax is derived by multiplying the average employee's salary by 1.45%.

3/ Joint Committee on Taxation Staff, Data on Distribution by Income Class of Effects of H.R. 3838, Tax Reform Act of 1986 (JCX - 28-86) (October 1, 1986), Table 4.

COMMITTEES:
FOREIGN AFFAIRS
JOINT ECONOMIC COMMITTEE
SELECT COMMITTEE
ON AGING

WASHINGTON OFFICE:
2464 RAYBURN HOUSE OFFICE BUILDING
WASHINGTON, DC 20515–1902
(202) 225–6306

OLYMPIA J. SNOWE
2D DISTRICT, MAINE

Congreſs of the United States
House of Representatives
Washington, DC 205[illegible]

DISTRICT OFFICES:

MARGARET CHASE SMITH
FEDERAL BUILDING
202 HARLOW STREET, ROOM 209
BANGOR, ME 04401–4980
(207) 945–0432

TWO GREAT FALLS PLAZA
SUITE 7B
AUBURN, ME 04210–5813
(207) 786–2451

197 STATE STREET
POST OFFICE BOX 722
PRESQUE ISLE, ME 04769–0722
(207) 764–5124

June 9, 1987

The Honorable Dan Rostenkowski
Chairman
Committee on Ways and Means
1102 Longworth HOB
Washington, D.C. 20515

Dear Chairman Rostenkowski:

Once again this year, as you consider budget issues, I urge you to reject changes in current law which would require the coverage of all state and local employees under Medicare.

As you know, in April, 1986, the Consolidated Omnibus Budget Reconciliation Act imposed mandatory Medicare coverage upon government employees hired after March 31, 1986. For those states, such as Maine, where there was previously little or no Medicare coverage for government employees, the COBRA provision presented financial difficulties. Even so, the coverage of new employees allowed governments to gradually transition state and local employees into Medicare and at the same time avoid jeopardizing existing employee benefit plans. With an average turnover rate for employees of 9 percent per year, all government employees will be under Social Security in a relatively brief period of time.

Yet, although the provision in COBRA has barely been implemented, we find ourselves again threatened by the expansion of coverage to all government employees. The economic impact of this action cannot be overstated. About 4 to 5 million low paid workers would be affected from the imposition of what amounts to a tax increase. They would face the equivalent of a tax increase of $67 in 1987; by 1991, this would increase to $333.

For the state of Maine, the coverage of all state and local employees would cost about $17.3 million. This comes at a time when states have experienced cuts of about 67 percent in federal appropriations, when revenue sharing has been eliminated, and when states are generally in a poor position to absorb further increases.

My vote for COBRA was a good faith effort to compromise on the issue of coverage of state and local employees under Medicare. I respectfully urge that the agreement reached under COBRA to cover only new government employees under Medicare be preserved.

Sincerely,

Olympia Snowe

OLYMPIA J. SNOWE
Member of Congress

Toledo Police Command Officers' Association / 1017 Summit Street / Toledo, Ohio 43604

June 24, 1987

Representative Dan Rostenkowski
Chairman, House Ways and Means Committee
1102 LHOB
Washington, D.C.

Dear Chairman Rostenkowski,

It has come to our attention that there is currently a move to require all public employees to contribute to the Medicare System. The Toledo Police Command Officers Association, as a member of the National Association of Police Organizations (NAPO), would like to express our opposition to any mandatory Medicare coverage for public employees.

It is our feeling that the Consolidated Omnibus Reconciliation Act of 1985, that requires only those local government employees hired after March 31, 1985 to be included in Medicare is not only the fairest approach but also the most economically feasible. This Act would not put an undo burden on current public employees or the local governments who would be required to pick up the tab for the employers contribution.

We ask you to please seriously consider the position the Toledo Police Command Officers Association and NAPO have taken on this issue when making any decisions regarding this matter.

Sincerely Yours,

George Gerken

George Gerken
Chairman
T.P.C.O.A.
Political Action Committee

COMMITTEE ON THE BUDGET
CHAIRMAN,
TASK FORCE ON COMMUNITY
AND NATURAL RESOURCES

COMMITTEE ON
FOREIGN AFFAIRS
CHAIRMAN,
SUBCOMMITTEE ON AFRICA
INTERNATIONAL ECONOMIC POLICY
AND TRADE

CHAIRMAN,
NORTHEAST-MIDWEST COALITION
WHIP-AT-LARGE

HOWARD WOLPE
THIRD DISTRICT, MICHIGAN

Congress of the United States
House of Representatives
Washington, DC 205

1535 LONGWORTH HOUSE OFFICE BUILDING
WASHINGTON, DC 20515
(202) 225-5011

610 SOUTH BURDICK STREET
SUITE 608
KALAMAZOO, MI 49007
(616) 385-0039

30 WEST COLUMBIA AVENUE
SUITE 8
BATTLE CREEK, MI 49015
(616) 961-4570

NORTH CAPITOL AVENUE
SUITE D1
LANSING, MI 48933
(517) 482-9388

RECEIVED
SUBCOMMITTEE ON HEALTH
JUN 24 198

June 22, 1987

The Honorable Dan Rostenkowski
Chairman, House Ways and Means Committee
1102 LHOB
Washington, D.C. 20515

Dear Dan:

It is my understanding that your Committee is now studying a proposal contained in the President's 1988 fiscal year budget proposal that would require coverage of all state and local government employees under Medicare.

For your Committee's review, I have taken the liberty of enclosing copies of two letters I received which detail the impact this proposal could have on two Michigan cities, Kalamazoo and Detroit.

Thank you for your consideration.

Sincerely,

Howard

HOWARD WOLPE
Member of Congress

HW:jpc

Enclosures

THIS STATIONERY PRINTED ON PAPER MADE WITH RECYCLED FIBERS

CITY OF KALAMAZOO, MICHIGAN

April 2, 1987

The Honorable Howard Wolpe
House of Representatives
1527 Longworth Office Building
Washington, DC 20515

Dear Representative Wolpe:

One proposal in the Administration's 1988 Budget requires mandatory Medicare coverage for public employees. The Kalamazoo City Commission's Legislative Committee has reviewed information on this subject, and on behalf of the City Commission, I am writing to urge you to oppose this provision in the Administration's Budget.

Currently the City has approximately 300 employees providing Public Safety (police and fire) services. These employees are not covered by Social Security or Medicare coverage. The City of Kalamazoo provides medical insurance to retirees, and these employees also contribute a larger percentage of their salary to our City pension system in recognition of the fact that they are not covered by Social Security.

To impose a requirement that all public employees be covered under Medicare would have a significant financial impact on both the City of Kalamazoo and our Public Safety employees. We estimate that the additional annual cost to the City would be in excess of $200,000.

At a time when the City's financial resources are very limited, due to a number of cutbacks in federal programs, we cannot support additional federal mandates such as the proposed Medicare coverage for all public employees. The City of Kalamazoo strongly opposes this provision and will work for its defeat in Congress. We appreciate your consideration of our position.

Sincerely,

KALAMAZOO CITY COMMISSION

Marjorie A. Springgate

Marjorie A. Springgate
Vice Mayor and
Chair, City Commission Legislative Committee

1

OFFICE OF THE MAYOR, 241 West South Street 49007-4796, 616-385-8017

224-3400

City of Detroit Executive Office

Coleman A. Young, Mayor

March 9, 1987

The Honorable Howard Wolpe
U.S. House of Representatives
1535 Longworth House Office Building
Washington, D.C. 20515

Dear Howard:

I write in opposition to the Administration's proposal for mandatory inclusion of state and local employees under the federal Medicare system.

All of Detroit's employees are currently covered by Medicare and Social Security except for 6,200 uniformed fire fighters and police officers. Inclusion of all of our fire fighters and police officers into Medicare would cost this city about $3 million per year. These employees would have to pay an equal amount, about $350-$400 per employee, more than wiping out any benefit they gained from the 1986 Tax Reform Act.

The Administration's proposal is not new. In 1985, Congress considered this same issue and adopted a compromise position, by providing that all employees hired after April 1, 1986, would be required to be included in the Medicare system. This phase-in allows for steady increases in revenue to the Medicare system while giving units of government and their employees a reasonable time to adjust to the added cost.

The loss of revenue sharing cost Detroit $32 million. Other urban aid programs have also been severely cut in recent years. If Congress accepts the Administration's proposal, Detroit and other cities will have another heavy fiscal burden to bear. We ask for your help in this very important matter.

Sincerely,

Coleman

COLEMAN A. YOUNG
Mayor

BEFORE THE BOARD OF SUPERVISORS
OF THE COUNTY OF YUBA
STATE OF CALIFORNIA

IN RE: RESOLUTION NO. 1987-151

RESOLUTION OPPOSING EXPANSION
OF MEDICARE PAYROLL TAX TO
INCLUDE ALL STATE AND LOCAL
GOVERNMENT EMPLOYEES

WHEREAS, state and local governments have been forced to assume major responsibility for reducing the federal deficit; and

WHEREAS, from 1979 to 1987, federal assistance to local governments was cut by 66% while total federal spending increased by 102%; and

WHEREAS, Yuba County is experiencing fiscal difficulties caused in part by federally mandated programs and the expiration of the Federal Revenue Sharing Program; and

WHEREAS, the proposed expansion of the Medicare payroll tax to include all employees of the County would result in an additional cost to Yuba County in the amount of $145,000;

NOW THEREFORE BE IT RESOLVED that the Board of Supervisors of the County of Yuba, State of California hereby opposes the expansion of the Medicare payroll tax.

BE IT FURTHER RESOLVED that copies of this Resolution be sent to members of the Senate Finance and the House Ways and Means Committees as well as to Senator Pete Wilson and Congressman Wally Herger, and the National Association of Counties.

PASSED AND ADOPTED at a regular meeting of theBoard of Supervisors of the County of Yuba, State of California on the 17th day of August, 1987, by the following vote:

AYES: Supervisors Deveraux, Dower, Harper, Mathews and McGill

NOES: None

ABSENT: None

ATTEST:

Clerk of the Board of Supervisors

BY: ______________________
Kathleen L. Burgess, Deputy

Chairman

[illegible]
[illegible]
BY Timothy P. Hayes

ADMINISTRATION EXCISE TAX PROVISIONS

STATEMENT BY KAREN FINKEL, EXECUTIVE DIRECTOR
NATIONAL SCHOOL TRANSPORTATION ASSOCIATION

My name is Karen Finkel, and I serve as the Executive Director of the National School Transportation Association (NSTA). I am pleased to have the opportunity to present this Committee with the views of NSTA on options to raise revenues in order to meet the reconciliation instructions to the Committee on Ways and Means contained in H. Con. Res. 93, the concurrent resolution on the Budget for Fiscal Year 1988. Specifically, NSTA is opposed to the elimination of excise tax exemptions on gasoline and diesel fuel for school bus contractors.

NSTA was founded in 1964 by private school bus contractors to "promote and foster the highest degree of safety in the transportation of school children." The Association represents approximately 27 percent of the nation's yellow school bus fleet, with members in all fifty states and Canada. The majority of private contractors, many who are smaller family-owned firms, are members of NSTA as well as state contractor associations. Increasingly, county school boards and local school districts are privatizing certain activities. Among these is the provision of pupil transportation services. NSTA members provide school buses, drivers, routing information, and other such services to counties or school districts on a contractual basis.

Current Law

The Energy Tax Act of 1977 extended to privately-owned intercity and local bus operations and school bus operations existing exemptions from retailers' excise taxes on diesel fuel, gasoline, and other items such as parts and tires. With technical correction provided for in the Tax Reform Act of 1986, school bus contractors became eligible for refund or credit of taxes paid for each. This meant, for example, exemption for the full 15 cents-a-gallon excise tax on diesel fuel and 9 cents-a-gallon on gasoline. The original action by the two tax writing Committees was predicted on policy goal that the Federal government should encourage greater use of more energy-efficient bus transportation. The Committees also moved to ensure that excise tax treatment of private transit and school bus operations be made consistent with governmental operations.

Administration Proposal

In its fiscal year 1988 budget submission to the Congress, the Administration proposed that some 22.4 billion dollars in new taxes and other revenue increases be enacted. Among its proposals for attaining that target, the Administration proposed repeal of gasoline and other highway excise tax exemptions for public and private bus operators provided in current law. The Congressional Budget Office estimates that adoption of this proposal would generate $500 million in savings over five years.

Why NSTA Opposes The Proposal

NSTA urges the Ways and Means Committee to reject the Administration's proposal to repeal current law excise tax exemptions for gasoline, diesel fuel and other items. Such exemptions were originally adopted to encourage greater use of public transportation, thereby relieving congestion on the roadways and conserving energy. These goals are as worthy today as a decade ago.

Furthermore, the additional operations cost for school bus contractors associated with the proposal would surely be passed along to the local school districts. Such an indirect local education tax would come at a time when Federal assistance is declining and state and local governments largely find themselves hard pressed to offset such losses. It is estimated that the annual cost of the Administration proposal for the average school bus contractor, and thus the school district serviced, would be nearly equal to the average annual teacher salary in our nation's elementary and secondary schools.

Thank you for your attention to our views and we look forward to working with the Committee in the future on this and other important issues where our interests converge.

PBGC PREMIUMS

August 4, 1987

The Honorable Dan Rostenkowski
Washington, D.C.

Dear Honorable Rostenkowski:

I have learned Congress is considering legislative action to make it easier for companies to siphon-off "surplus" monies from existing pension funds. I emphatically oppose this type of law. It will encourage companies to raid the funds of millions set aside for their workers and retirees.

These excess funds should be used to restore the worth of retirees' pensions, not to finance corporate ventures.

I urge --no, I beg you to support only legislative action that meet the basic needs of employees and retired persons as they are applicable to their pension rights.

I retired from Lear Siegler, Inc., Instrument Division in 1982 and after 23 dedicated years receive only $186 per month. LSI has never given its retirees a COLA increase or an adjustment. Over 86% of those who retired before 1980 are receiving less ~~more~~ than $200 a month. The company invested the pension benefits which represented deferred salary and wages promised us.

The company was recently sold to Fortsman Little and the $85 million "surplus" in our pension fund is quite attractive to the new owners.

I understand the new legislation Congress is considering will allow companies to withdraw the surplus, provide a 25% cushion for the present workers and allow the government a very profitable excise tax. No wonder the Reagan Administration is interested in such a legislative change. Where do the retirees fit in?

The private pension law says unequivocally that pension money must be used solely in the interest of workers and retirees.

Please extend your efforts to provide a fair and equitable legislation for employees and retirees who have worked many years to make a company successful.

Sincerely,

Dorothy P Bauman

Dorothy P. Bauman
1017 Paradise Lake Rd.
Grand Rapids, Mi. 49506

Similar letters were submitted by the following:

Mr. Jack Constant, Grand Haven, Michigan
Mr. Carl Menn, Grand Rapids, Michigan
Mr. James T. Roche, Cleveland, Ohio

DOW CHEMICAL U.S.A.

WILLARD H. DOW CENTER
MIDLAND, MICHIGAN 48674

August 19, 1987

The Honorable Dan Rostenkowski
Chairman, House Committee on Ways & Means
1102 Longworth House Office Building
Washington, DC 20515

Dear Chairman Rostenkowski:

The Committee on Ways and Means is currently considering legislation to reform the minimum funding standards and to increase the Pension Benefit Guaranty Corporation (PBGC) premiums for private pension plans. We support your efforts to ensure that companies who promise employees pension benefits are responsible in their efforts to fund those benefits.

However, we have a concern of a more technical nature with respect to the interest rate that will be used to discount future liabilities for PBGC premium purposes. Use of an unreasonably low, long-term interest rate could cause a "fully" funded plan to pay the additional variable rate premium. Such a result is philosophically inconsistent with the concept of a variable rate premium designed to deter companies from underfunding their pension plans.

If PBGC interest rates are required for discounting, they could greatly overstate liabilities since they tend to be lower than those actually attainable by most plans. We believe it would be reasonable to use assumptions currently allowed by ERISA, but we also understand that such a wide range of assumptions would make the estimate of PBGC premium funding very difficult.

As a compromise, it may be more feasible to use the following proposal. Allow those companies who issue publicly audited financial statements to elect to use interest rates which meet Financial Accounting Standard 87 (FASB 87) or PBGC rates. FASB 87 rates must be approved by a corporation's public auditor and would provide the federal government with more quantifiable data than does ERISA, which allows for greater freedom of interest rate assumption. FASB 87 would also allow corporations to assume rates closer to those actually attainable by most pension plans.

Perhaps a middle ground can be found between the wide band of rates allowed by ERISA and the conservative PBGC rates. Such a solution would help to alleviate our concern.

Your consideration of this idea is appreciated. If you or your staff have questions about this suggestion, please feel free to contact Donna Akers in our Washington, DC office at 429-3429.

Sincerely,

L. J. Bollinger
Director of Employee Benefits
2020 Willard H. Dow Center

Statement of

National Steel Producers Association

The National Steel Producers Association, a steel trade group representing non-integrated domestic steel producers, is submitting this statement on the proposal of the House Ways and Means Oversight Committee to impose more rapid funding requirements on defined benefit pension plans, and to increase annual premiums for these plans. We wish to register strong opposition to this proposal.

The proposal calls for a variable rate premium structure for all plans, with a new base premium of $15 per worker for all plans. Additional premiums for underfunded plans would also be required, equal to $5.50 for each $1,000 of underfunding in those plans funded below 110% of vested benefits. Total premiums could rise as high as $50 per participant, annually.

Staff estimates show that annual premiums for defined benefit plans should average $19.50 per participant under the proposal. Adoption of this proposal would therefore increase the average annual premium from the $2.60 level extant prior to 1986, to $19.50, a staggering increase of 650% or $16.50 per participant. The current annual premium of $8.50 would increase on average by 129% under the proposal.

That is an impact which could create financial hardship for many companies. For those companies not in danger of Chapter 11 bankruptcy but with ongoing plans not funded up to the level of past service liabilities, it could cause severe hardship. This PBGC funding proposal could be counter-productive, in that it could push some companies out of business entirely, and/or force further terminations of defined benefit pension plans. The result would be additional transfers of liabilities to the balance sheet of PBGC, which, in turn, would have to further increase annual termination insurance premiums and increase funding requirements, inevitably leading to a new round of abandonment of defined benefit plans, and additional transfers of under-funded past service liabilities to the PBGC.

Why is this proposal being offered? The answer is that the action of a few companies to file for Chapter 11 reorganization will soon render the the PBGC insolvent, unless steps are taken to solve its pension funding problem. Due to several Chapter 11 filings, PBGC has now assumed responsibility for approximately $4 billion of unfunded pension liabilities, approximately $3 billion of which have been transferred to PBGC as a result of the termination of some steel company plans. This highlights the structural deficiency inherent in the program. Our federal pension plan insurance program covering thousands of companies has been structured to lead inevitably to its own destruction, triggered by the financial collapse of a few companies. Moreover, the alternative appears to be a proposal to transfer a major share of the burden to solvent companies whose on-going pension plans may not be fully funded. A better way must be found.

The Congress should carefully review ways to rectify the present funding imbalance rather than taking action as suggested under this proposal to gain a temporary alleviation of PBGC funding requirements to the long-term detriment of defined benefit plans.

Steel Transition Rule

We also wish to comment on the steel transition rule contained in the proposal. The draft proposal provides for a "special transition rule for steel companies", stating that the required minimum contribution for a plan year must be the amount required under present law, or an amount that would not exceed a modest percentage increase...whichever is greater. Given the current precarious financial condition of several major steel companies with on-going pension plans, it would be fool-hardy to impose funding requirements on them which might push them to the brink of, or into insolvency, thereby increasing PBGC's pension liabilities. Therefore we fully support the transition rule for steel producers, should the Committee proposal becomes law. What we do not appreciate and cannot accept is the narrow definition of an eligible steel company contained in this proposed transition rule. The proposal would limit eligibility for the transition rule only to those companies described in Section 806(b) of the Steel Import Stabilization Act... defined as follows: "the term major company means an enterprise whose raw steel production in the United States during 1983 exceeded 1.5 million net tons".

What is so significant to the formulation of steel sector public policy about 1.5 million tons of steel production in 1983? The 806(b) definition was a purely arbitrary definition, originally conceived to ensure that major steel companies reinvest their cash flow from steel back into steel operations, as a condition of maintenance of the VRA's. It has no other public policy significance. But it was also used in the recent tax bill to provide extended investment tax credit carry-backs only to a few major steel companies that qualified under the Section 806(b) definition, denying equal access of smaller steel producers to these carry-back provisions. This, by any criterion, is arrant discrimination against the smaller steel producers and raises a fundamental question of equity.

Will public policy for the steel sector continue to provide benefits only for major steel producers as defined under Section 806(b) of the Steel Import Stabilization Act contained in the Trade and Tariff Act of 1984? Or will the Congress end this steel-specific discriminatory treatment in tax and pension policy legislation of a major segment of the steel industry by changing the definition to include smaller steel companies. This would redress unintended inequitable treatment of smaller companies and conform to the reality of the American steel industry's structure, i.e., one that consists of both large and small steel companies. Moreover, there are ways to draft an equitable definition of a steel company with negligible adverse revenue consequences. As we are certain it is not the intent of the Congress to discriminate against smaller steel companies, denying them equal or equivalent treatment under U.S. law, we urge the Congress to review such options with us, and change the definition of a steel company for purposes of steel-specific tax and pension policy.

In Summary:

The structure of the PBGC insurance program should be modified inasmuch as terminations of some unfunded plans could trigger terminations of other plans, as PBGC premiums are raised to offset the increased liabilities it absorbs resulting from additional terminated plans. A system must be devised which prevents massive increases in PBGC premiums for companies that have not caused the problem, and whose pension plans would otherwise continue at existing premium rates whether or not they are fully funded with respect to past service liabilities. Future changes might include the improvement of PBGC claims in bankruptcy, the creation of a new separate agency to assume reponsibility for the $4 billion of contingent liabilities of PBGC, or other methods of funding from new sources of general revenues.

A serious problem of equity under U.S. laws is raised by defining the steel industry for tax and pension insurance legislative purposes as that small group of large companies eligible under Section 806(b) for such preferential treatment. Fairness dictates the need for an immediate change to broaden the definition of an eligible company.

ASAPT

AMERICANS FOR SUBSTANCE ABUSE PREVENTION AND TREATMENT
National Headquarters
400 First Street, NW
Suite 712
Washington, DC 20001
(202) 347-7878
(800) 255-2727

Advisory Committee

George Gallup, Jr.
Pollster
Honorary Chairman
Pat Boone
Entertainer
Joseph A. Califano, Jr.
Attorney
Hon. Herman E. Talmadge
Former U.S. Senator
Abigail Van Buren
Syndicated Columnist
Raymond Chavira
Board Member
California Council on Alcohol Problems
Michael E. De Bakey, M.D.
Heart Specialist
Hon. Wilbur D. Mills
Attorney
Ernest P. Noble, Ph.D., M.D.
Director, Alcohol Research, UCLA
Sue Rusche
Director, Families in Action
Jokichi Takamine, M.D.
Chairman, AMA Committee
on Alcoholism
Dale P. Dirks
Treasurer

STATEMENT OF

THE AMERICANS FOR SUBSTANCE ABUSE PREVENTION AND TREATMENT

PRESENTED TO THE

COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

CONCERNING

INCREASING THE FEDERAL EXCISE TAXES ON ALCOHOL
TO MEET REVENUE INCREASES

ON

JULY 7, 8 , 9, 1987

Mr. Chairman and Members of the Committee, in 1951, federal excise taxes on all alcoholic beverages were raised to help finance the Korean War effort. Taxes on distilled spirits were increased in 1985 -- 34 years later -- but the excise taxes on beer and wine remain unchanged.

The Americans for Substance Abuse Prevention and Treatment (ASAPT) believe it is time to equalize taxes on all alcoholic beverages to finance another war. The war on alcohol and drug abuse in America. Listed are some important figures for the Committee's consideration:

Alcohol Toll on Human Lives and the Economy

- Approximately 15 million Americans, including 3 million adolescents suffer from alcoholism or problem drinking.

- In a Gallup Poll, 81% of those asked said alcohol abuse is a major national health problem.

- Nearly three times the number of Americans killed in Vietnam die each year of alcohol abuse or alcoholism. Alcoholism shortens life expectancy by an estimated 10-15 years.

- More than 30 diseases are caused or aggravated by alcohol abuse including: pancreatitis, esophageal cancer, peptic ulcer, cirrhosis of the liver, tuberculosis, endocrine disorders and birth defects.

- More than one-half of all motor vehicle fatalities and deaths from falls or fires involve alcohol abuse.

- Alcohol abuse costs the nation, drinkers and abstainers alike, a total of $120 billion annually in lost productivity, health and medical care, crime and violence, sick leave and social welfare.

- Alcohol abusers utilize a disproportionately high share of health insurance and Medicare benefits, thus driving up cost for all persons.

The present need to generate additional funds for alcohol and drug abuse and other health-related programs is particularly acute. The enactment of the Balanced Budget and Emergency Deficit Control Act of 1985 and other budgetary constraints is expected to result in substantial cutbacks in appropriations for national health programs, including Medicare and the National Institute on Alcohol Abuse and Alcoholism (NIAAA).

To offset the effects of such cutbacks, the Americans for Substance Abuse Prevention and Treatment supports a tax increase on beer and wine as a means of maintaining adequate funding levels for NIAAA, state block grants, alcohol prevention programs in schools, alcoholism and drug abuse treatment and other health care programs, such as Medicare and Medicaid.

The simplest way to increase taxes on beer and wine would be to equalize the tax rates for all alcoholic beverages. Adjusted for alcohol content, beer is currently taxed at one-fourth the rate of distilled spirits, and wine is taxed at one-seventeenth the rate. The current federal excise tax equates to less than three cents on a can of beer and less than a penny on a glass of wine.

The National Alcohol Tax Coalition estimates that an increase in federal excise taxes could generate additional revenues of between $4.3 billion and $20.5 billion annually. Currently, $5.4 billion is generated in federal excise taxes, or less than one percent of all federal revenues. In 1951, when beer and wine taxes were last raised, alcohol taxes accounted for approximately five percent of all federal revenues.

Increased alcohol taxes would, of course, be user taxes, and would have no impact whatsoever on the estimated 36 percent of the population that abstains from alcohol use. Also, it would have minimal effect on light and moderate drinkers. The U.S. Department of Health and Human Services estimates that 10 percent of all drinkers account for 50 percent of the alcohol consumed in the United States.

The majority of Americans favor increasing the tax on alcoholic beverages. More than half of the people surveyed in a 1983 Gallup Poll said they favored doubling the federal tax on alcoholic beverages. Many prominent organizations including the American Association of Retired Persons, the National Council on Alcoholism, the American College of Preventive Medicine, and the Center for Science in the Public Interest support the tax increases.

Also, several dozen leading economists, including Stanford's Victor Fuchs and Princeton's Alan Blinder, have petitioned Congress to increase federal excise tax on alcoholic beverages. They "believe that the public health costs and other external costs associated with the consumption of alcoholic beverages are so significant as to justify substantial excise taxes on those beverages."

Alcohol abuse in America costs the nation more than $120 billion annually -- approximately 25 times the amount generated in excise taxes -- and accounts for about 10 percent of the nation's death toll. And alcohol consumption is rising. Per capita consumption rose approximately one-third from 1960 to 1982, with beer and wine leading the way. Advertising expenditures for alcoholic beverages have increased to approximately $1 billion a year, including more than $500 million by the beer industry alone.

Duke University researchers estimate that if alcohol taxes doubled and then equalized, consumption of alcoholic beverages could be expected to drop by approximately 14 percent.

The Americans for Substance Abuse Prevention and Treatment joins with other organizations in urging an increase in beer and wine taxes and earmarking the revenue for:

- -- Alcohol research
- -- Prevention
- -- Treatment
- -- And support of health care programs such as Medicare Medicaid and publicly funding agencies such as NIAAA, NIDA and the National Institute on Mental Health.

Thank you for the opportunity to present our views.

Association of American Vintners
and
Wine Institute

Summary of Opposition to Wine Excise Tax Increases
Committee on Ways and Means
U.S. House of Representatives
July 9, 1987

1. Even at the present tax level of $.17 per gallon, from 1984 to 1986, the consumption of table wine — the wine most consumed in America — has dropped 50 million gallons, from 401.3 million to 350.6 million gallons. U.S. produced table wine has declined 6%, from 283 million to 267 million gallons. The overall decline in U.S. produced table wine sales can be traced to the fall off in the large, popularly priced "jug" wine market, which has decreased an estimated 10 million gallons a year.

   Wine cooler sales which have increased from 34.2 million to 120.4 million gallons in the last 3 years, have obscured the plight of American vintners and growers. If the non-wine portion of wine coolers is factored out, total per capita wine consumption in America has declined from 2.27 gallons in 1984, to 2.25 gallons in 1985, to 2.18 gallons in 1986.

2. Regressive wine and beer tax proposals that call for a change in the traditional method, based on a specific tax per gallon, to revolutionary and unprecedented new formulas tied to alcohol content and "proof gallon," if enacted, will produce a shattering blow to the wine economy and invalidate all tax projections and revenue estimates.

   For example, one of the Joint Committee on Taxation draft options to raise wine and beer taxes to the "proof gallon" equivalent of spirits would result in a 1,665% tax rate increase from $.17 per gallon to $3.00 per gallon, for 12% table wine, the most representative American wine. For a typical $3.00 bottle of wine, using wholesale and retail markups of 25% and 50%, the price would increase about $1.10 per 750 ml bottle, and about $2.20 per 1.5 ml bottle. For a $7 jug wine of 4 liters, using the same markups, such a tax would add another $6.00 to the price of wine. While other revenue options are less extreme they are still crippling; and one which calls for a 3,330% increase would be tantamount to confiscation.

3. These huge tax increases on table wine would fall especially hard on lower and middle income consumers. About 60% of all American wine (excluding coolers) is sold as jug wine in bottles of 1.5 liters or larger. Approximately 80% of all American table wines are sold at $3.00 or less per 750 ml ($18.00 or less per case f.o.b.). Reliable surveys report that 74% of wine is consumed in the home; and 66% is consumed with food, verifying the knowledge that wine is essentially a mealtime beverage for most wine households. Many of these consumers, according to a recent study by Peat, Marwick Main & Co., commissioned by the Coalition Against Regressive Taxation, would pay more in increased excise taxes than what they would save in income taxes as a result of last year's Tax Reform Act.

4. In 1985, federal excise taxes on all wines, American and foreign, generated $274.5 million. In 1986, with falling sales in several categories, that revenue fell to $270.3 million. Champagne and sparkling wine constituted 55% of that total, declining from $159.8 million in 1984 to $157.1 million in 1985 to $150.3 million in 1986. The champagne tax at $3.40 a gallon, converts to $14.17 per proof gallon (for 12% alcohol by volume), making it higher than spirits which is taxed at $12.50 per proof gallon. Yet, tax

writing staffs are contemplating formulas and rates, that on paper could generate as much as $1 billion more in FY 1988, and $3 billion more over the next three fiscal years. The unreality of squeezing such money out of a faltering industry and hard pressed consumers should be readily apparent and immediately dropped.

5. While the timing of increased taxes is never good, this period is an especially vulnerable one for the American wine industry which is still in its infancy. In addition to the major producing regions, wine grapes are being grown and new wineries are emerging in 34 states. This fledgling development has received positive consumer support, has offered the prospect of new agricultural alternatives, and has assisted local tourism and hospitality ventures. Federal wine excise tax increases would be contrary to recent state farm bills designed to encourage local wine and winegrape development.

   This infant industry faces the special burden of vineyard farming whose characteristic is that it takes four years to produce a commercial crop and eight years for the vineyard to reach full production. Vineyards generally do not show a positive cash flow before their fifth year; wineries often not until their tenth year. (30% of American wineries are less than 6 years old). A large federal excise tax increase could be the single strongest element that snuffs out any ability for infant wine state economies to survive.

6. Given the dramatically regressive nature of the "proof gallon" formulas, estimates of a precipitous 30% loss in sales volumes must be viewed as credible. The popularly priced, and already troubled, "jug" wine category could plummet even further. The loss of wine sales will result in an oversupply of grapes, and depress prices for the entire grape-growing community, which includes growers of raisin, table, and juice grapes.

   A conservative analysis of a 30% drop in American wine sales would cause a 135 million gallon loss, worth about $810 million f.o.b., or $1.5 billion retail. The resulting decrease of 870,000 tons of grapes would force the economic abandonment of over 100,000 acres or 800 vineyards, and an estimated 51,000 jobs. Thus, projected federal revenue gains must be recalculated and put in the context of offsetting losses in income taxes. At the state level, where 47 states tax table wine higher than the $.17 per gallon federal excise rate, we can expect a loss of over $50 million in state excise taxes and license fees. Most observers are unaware that the federal excise tax is in addition to state excise taxes, state income taxes, property taxes and, in many instances, sales taxes which generate hundreds of millions of dollars and which make our consumers among the most taxed citizens in America.

7. Separate and apart from the analysis of future losses, triggered by massive new excise increases, many winegrape growers face bankruptcy right now. The price of grapes in many areas is at a level that is well below the farmers' cost of production. The value of San Joaquin vineyards, where most California winegrapes are grown, has declined from 50% to as much as 80% between 1982 and 1986. In 1986, 79,000 acres of California vineyards were either abandoned or not harvested.

   Across the country, vineyard conditions are truly stark. Though American wines receive world class recognition, they are impacted negatively by such factors as international subsidies and governmental restrictions. About 1,000 of the 1,200 wineries in America are small businesses primarily owned and operated by families, who raise their own grapes and make their own wine. These families produce less than 15,000 gallons a year. About 80% are losing money; 86% of their grape growing partners are losing money. All this prevails at existing wine excise tax rates.

8. Our competitive position with foreign wineries and winegrape growers can be further eroded. Mainly as a result of foreign governmental subsidies and currency fluctuations, foreign wines until 1986, enjoyed an uninterrupted decade of market expansion, especially in the lower price ranges. In 1975, their share of the table wine market was 17%. In 1985, that share had grown to 30%. In 1986, the combination of European wine scandals, which underscored America's high quality health standards, and a more realistic dollar, caused a shift to 24%. But the American balance of trade deficit for all wine categories deteriorated further as foreign wine values rose $20 million from $1.01 billion in 1985 to $1.03 billion in 1986.

   While an increase in the federal excise tax on wine applies to both American and foreign wine in the U.S. market, we can anticipate that many foreign governments will absorb any excise tax increase through additional subsidies. This would make the impact much more severe on the American producer. (Overall, the value of the various subsidies is estimated at 29% of the value of French wine, 19% of Italian wine, and 17% of West German wine). Moreover, on the other side of the trade ledger, the American wine industry continues to be seriously impeded by discriminatory tariff and non-tariff trade barriers in its export drive to open overseas markets.

9. A significant flaw in the "proof gallon" approach concerns champagne and sparkling wine which possess the same alcohol content as table wine. Champagne and sparkling wine is presently taxed at $3.40 per gallon, which on a "proof gallon" basis is higher than spirits. If the revenue options to increase the wine tax to $12.50 a proof gallon were enacted the tax on champagne at 12% would be reduced from $3.40 to $3.00 a gallon, while the tax on 12% table wine would rise dramatically from $.17 to $3.00 a gallon. This inequity results from the attempt to impose artificial formulas and mathematical equations on divergent products.

10. The "proof gallon" approach could create new administrative costs. The present simple excise tax rates of $.17 a gallon for still wine with an alcohol content not over 14% and $.67 a gallon for a still wine over 14% and less than 21%, would be replaced by a complex formula for every single percentage. (See attached chart.) BATF most likely would have to add additional personnel to administer the new taxing code which could also trigger new regulatory burdens regarding wine production percentage variances and labeling requirements.

CURRENT WINE EXCISE TAXES VERSUS PROPOSED NEW RATES

	Federal Excise Tax Per Wine Gallon		
Alcohol by Volume	Current Basis 1/	Excise Tax on Proof-gallon Basis 2/3/	Tax Increase
21%	$0.67	$5.25	+ 684%
20%	$0.67	$5.00	+ 646%
19%	$0.67	$4.75	+ 609%
18%	$0.67	$4.50	+ 572%
17%	$0.67	$4.25	+ 534%
16%	$0.67	$4.00	+ 497%
15%	$0.67	$3.75	+ 460%
14%	$0.17	$3.50	+ 1959%
13%	$0.17	$3.25	+ 1812%
12%	$0.17	$3.00	+ 1665%
11%	$0.17	$2.75	+ 1518%
10%	$0.17	$2.50	+ 1371%
9%	$0.17	$2.25	+ 1224%
8%	$0.17	$2.00	+ 1076%
7%	$0.17	$1.75	+ 929%
6%	$0.17	$1.50	+ 782%
5%	$0.17	$1.25	+ 635%
4%	$0.17	$1.00	+ 488%
3%	$0.17	$0.75	+ 341%

1/ Still wine.

2/ If taxed on the same alcohol content basis as is now in effect for distilled spirits ($12.50 per proof gallon), wine would be taxed at a rate of $ 0.25 for each percent of alcohol by volume.

3/ Champagne containing 12% alcohol by volume presently has an excise tax of $3.40 per gallon, or $14.17 per proof gallon. Current rates and proposed new rates for champagne would be:

Alcohol by Volume	Current Basis	Excise Tax on Distilled Spirits Proof-gallon Basis	Tax Change
11%	$3.40	$2.75	- 19%
12%	$3.40	$3.00	- 12%
13%	$3.40	$3.25	- 4%

BACARDI IMPORTS, INC.
[illegible]

August 13, 1987

The Honorable Dan Rostenkowski
House Ways and Means Committee
Washington, D.C. 20515

Dear Congressman Rostenkowski:

It is of grave concern to me that there is a possibility that in September Congress might consider raising the excise tax on liquor as a means of reducing the deficit. A new tax increase would be devastating to our industry as we have already felt the results of the previous heavy taxations in the form of lower sales and higher job losses.

There is a limit, which probably has been already exceeded, as to how much taxation our industry can stand.

Please vote no on any liquor tax increase.

Sincerely yours,

BACARDI IMPORTS, INC.

Steven Naclerio

Steven Naclerio
Vice President
and General Counsel

SN/sk

BACARDI - THE WORLD'S GREAT RUM

Representative Dan Rostenkoruski
Chairman
House Office Building
Washington, D.C. 20515

Dear Chairman Rostenkoruski:

Please use your influence to get bill #709 passed when it comes up for vote. I would like to see this action to increase federal tax from the current percentages on beer, wine, and liquor.

I feel this would place the cost incurred in economic damage and deaths related to alcohol in its proper place.

I would like to voice my approval of this tax increase proposed by the national alcohol tax coalition.

Sincerely,

Mr.& Mrs. Robert C. Baker
4112 15th St.
Moline, Il. 61265

Robert O Baker
Margaret L. Baker

BRUNSWICK HOSPITAL CENTER
DEPARTMENT OF MEDICINE AND NUTRITION
76 LOUDEN AVENUE
AMITYVILLE, NEW YORK 11701

JOSEPH D. BEASLEY, M.D.
DIRECTOR

TELEPHONE
(516) 789-7031

July 23, 1987

TO: HOUSE WAYS AND MEANS COMMITTEE:

Re: ALCOHOL EXCISE TAXES

I am writing to inform you that I am strongly in favor of raising the excise tax on alcohol in order to deal more effectively with the problem of alcoholism and drug abuse in the country. This disease is probably the most important contributor the rising spiral of health costs in this nature. Also, is probably the single greatest cause of human suffering, ranking up there with heart disease, stroke and cancer.

I hope that you will give full consideration to the seriousness of this measure.

Respectfully submitted,

Joseph D. Beasley

Joseph D. Beasley, M.D., M.P.H., D-P, D.T.M.& H. (Lond.)
Director Department of Medicine & Nutrition
Medical Director, Brunswick House
Brunswick Hospital Center
Bard Center Fellow in Medicine & Nutrition

JDB:ph

EDITORIALS ATTACHED TO THIS LETTER HAVE BEEN RETAINED IN THE COMMITTEE FILES

TESTIMONY SUBMITTED BY

JAMES C. SANDERS

PRESIDENT, THE BEER INSTITUTE*

*The Beer Institute represents 35 United States brewers and 65 associate members. A list of members is appended to this testimony.

OVERVIEW

This statement by the Beer Institute clarifies and amplifies testimony to the House Committee on Ways and Means by Thomas P. Donohue on behalf of the Coalition Against Regressive Taxation (CART), and by reference incorporates that testimony into this document. The Beer Institute is a member of CART.

The following points are emphasized by The Beer Institute regarding various options for raising beer excise taxes submitted by the staff of the Committee on Ways and Means (the Staff Options):

0 Increased federal reliance on excise taxes will shift a greater portion of the nation's tax burden to middle- and lower-income groups. Such a highly regressive fiscal policy is both unfair and unwise.

0 Using excise taxes to generate billions of dollars in additional federal revenue will effectively repeal last year's tax reform act for the nation's moderate income families.

0 Of all excises, beer excise taxes are among the most inefficient and regressive. Beer drinkers -- a group comprised predominantly of America's working men and women -- pay from $2 to $3 at the cash register for every dollar realized by the federal government through beer taxes.

0 Arguments that beer taxes should be raised to recoup the "social costs" caused by alcohol abuse represent unsound fiscal policy. Such arguments ignore the substantial scientific evidence of health benefits from moderate consumption. And further, forcing responsible consumers to pay higher taxes will not help abusers.

0 So-called "equalization" of the beer tax rate with that of liquor is in reality nothing more than a 400% tax hike on working America's beverage of choice. This would disrupt a longstanding and sensible approach that recognizes the fundamental differences that exist between these beverage types.

0 Increased reliance on federal beer excise taxes will disrupt a major industry that provides direct employment to more than 200,000 Americans, costing thousands of jobs.

For all of these reasons, the Committee is urged to reject any increased reliance on excise taxes in general -- and beer excise taxes in particular.

EXCISE TAXES -- AN UNWISE WAY TO REDUCE THE FEDERAL DEFICIT

During the 1986 debate over tax reform, the Senate Finance Committee gave serious consideration to de facto 54% increase in federal excise taxes. After extensive hearings on the unfairness, regressivity and inefficiency of excise taxes, the Finance Committee abandoned that approach in favor of more equitable tax policies.

Now, one year later, excise taxes are again receiving serious consideration as a means of meeting all or part of anticipated revenue needs.

However, since excise taxes are based on consumption patterns rather than on the taxpayer's ability to pay, they are no more acceptable today than in 1986. For it is wrong to think that excise taxes are levied on individual industries or specific products. They are levied on people -- predominantly on middle- and low-income consumers who devote a greater portion of their income to the taxed items. As such, excise taxes are highly regressive.

Earlier this year, the Congressional Budget Office studied the distributional impact of higher excise taxes on beer, wine, liquor, tobacco, gasoline, air fare and telephone service. It found that the impact of an increase in such taxes would be:

> "... noticeably regressive. The average increase in taxes as a percentage of total income would be about twice as large (more than three times as large in the case of the tax on beer or tobacco) for families with incomes between $10,000 and $20,000 compared to families with incomes of $50,000 or more" (Congressional Budget Office, The Distributional Effects of an Increase in Selected Federal Excise Taxes, January, 1987).

INCREASED RELIANCE ON EXCISE TAXES WILL ELIMINATE TAX REFORM FOR MOST AMERICANS

In fact, reliance on higher excise taxes is little more than a form of reverse Robin Hood-ism, taking the benefits of tax reform away from middle- and low-income groups, while preserving them for the wealthy.

It has been estimated that an $18 billion increase in federal excise taxes would constitute an approximately $285 across-the-board tax hike for all American households (Quick, Finan & Associates, Federal Excise Taxes: Cost to the Average American Household, July, 1987). Such a regressive tax increase will effectively eliminate the benefits of last year's tax reform law for any household that realized less than that amount in reduced tax payments.

And that includes most middle- and lower-income Americans. As noted in a study released earlier this year:

> "... the excise tax increase for low income taxpayers greatly exceeds the tax reduction these same taxpayers received from the Tax Reform Act of 1986. For families with incomes of less than $10,000, the excise tax increase is nearly 5 times as great as the income tax reduction. In direct contrast, for taxpayers with incomes in excess of $100,000, the excise tax increase is only 6 percent of the enacted income tax reduction" (Peat, Marwick, Main & Co., An Analysis of the Regressivity of Excise Taxes, May, 1987).

Throughout the debate over tax reform, Congress emphasized "leveling the playing field" ... building a tax system that treats citizens fairly, based on their ability to pay. But "preserving" tax reform by raising excise taxes is an illusion that would, in many respects, represent the antithesis of reform.

The 99th Congress worked hard to make the tax system more equitable for all Americans. It is to be hoped that the gains made will survive efforts by the 100th Congress to meet deficit reduction targets.

BEER TAXES -- A REGRESSIVE AND INEFFICIENT WAY TO GENERATE ADDITIONAL REVENUE

All excise taxes are regressive ... but few are as regressive as the excise tax on beer.

The Congressional Budget Office study compiled earlier this year identified beer taxes as one of the two most regressive forms of excise tax. That is because beer consumers are overwhelmingly working men and women, with two-thirds of American beer sales accounted for by families with annual incomes of $30,000 or less.

Looked at another way, households with incomes in the $20,000 to $25,000 range spend more than 50% of their alcohol beverage budget on beer. Conversely, those with family incomes of more than $50,000 spend only about 25% of their alcohol beverage budgets on beer (Bureau of Labor Statistics, Consumer Expenditure Survey, 1980-81). Since beer is most popular among American working men and women, tax policies that raise the price of beer are highly regressive and place an unfair burden on people who are already paying their fair share.

In fact, raising the excise taxes on beer is one of the most regressive Staff Options presented to the Committee. It is also one of the most inefficient, since it would end up costing consumers from $2 to $3 at the cash register for every dollar in added tax revenue realized by the government.

This extreme inefficiency results from the fact that federal excise taxes are levied at the brewer level, and thus become an intrinsic part of the wholesale and retail price of beer. Any additional tax levied on the brewer will be subject to normal markup as the product moves toward the marketplace. By the time it reaches the consumer, it will have been marked up twice -- and typically will be more than twice as large as it was at the brewer level. As a result, the total consumer cost of any federal excise tax increase is more than double the amount of revenue collected by the government.

And beer consumers are already paying a disproportionately high tax rate. Every time one of America's 80 million beer drinkers buys a six-pack, he or she pays about three times more tax than when purchasing other goods which have no excise taxes. Beer drinkers pay $1.6 billion a year in federal excise taxes, plus $1 billion annually in state excise taxes and license fees, plus another $1.5 billion in state and local taxes.

In fact, the price of beer includes more for taxes than for *all* agricultural raw materials (including hops, barley and grains) plus the *total* payroll of the brewers who produced it -- *combined*.

To put the current tax burden on beer into full perspective, it should also be remembered that in the past 35 years federal excise taxes have been completely removed from such items as stock transactions, furs, jewelry, perfume, silver bullion and slot machines. During that same period, federal and state excise tax collections on beer have grown by almost 600 percent. Given these facts, one must wonder why excise taxes are sometimes described as "luxury" taxes.

EXCISE TAXES ON BEER SHOULD NOT BE RAISED TO RECOUP "EXTERNAL SOCIAL COSTS"

Some observers have maintained the federal excise tax on beer should be raised to recover the social cost of alcoholism and alcohol abuse. While the brewing industry agrees that these problems are important societal issues, they cannot be used as a legitimate justification for higher taxes:

0 Many consumer goods carry "social costs," but are not subjected to discriminatory taxation. Coffee, candy, soft drinks, fast foods, eggs, autos and even prescription drugs can cause problems if misused or abused. But no one has urged that they be taxed.

0 Moderate consumption of alcohol has been shown by scientific research to provide health benefits ... a fact totally ignored by the "external social cost" theory. To cite just one example, a 10-year study by the Kaiser-Permanente Health Plan found that moderate drinkers have a lower death rate than either heavy drinkers or abstainers. Thus, even abstinence can be said to create a "social cost."

0 Manipulating the tax code to increase the price of alcohol beverages will penalize the responsible drinker but leave the abusive drinker's behavior unchanged. Higher taxes may cause abusive drinkers to switch to cheaper products, but will not solve abuse. That is why Stanton Peele, of Organization Health Systems, recently wrote that:

> "The evidence is ... that control of supply policies will never reduce substance abuse significantly and that such policies may backfire by propagating images of substances as being inherently overpowering." ("The Limitation of Control-of-Supply Models for Explaining and Preventing Alcoholism and Drug Addiction," Journal of Studies on Alcohol, Vol. 48, No. 1, 1987).

Increases in the excise tax on beer cannot be justified on the theory that alcohol abusers -- or their families -- will somehow be helped by increasing the cost of beer, wine or liquor.

THE EXCISE TAX RATE ON BEER SHOULD NOT BE "EQUALIZED" WITH THAT OF LIQUOR

The proposal to "equalize" the federal excise tax rate on beer with that of liquor amounts to nothing more than a 400% tax increase on the 80 million working Americans who drink beer. It would do nothing to make the tax code more "equal".

In fact, such an increase is so drastic that it would completely disrupt existing consumption patterns, raising the federal taxes paid by beer drinkers from the current level of $1.6 billion to approximately $6 billion a year. This would encourage consumers to shift from beer to hard liquor, the most concentrated form of alcoholic beverage.

Creating a tax structure that makes a bottle of cheap vodka less expensive than a 6-pack of beer is very troubling from a public policy perspective. And there is also solid evidence that causing consumers to switch from a domestic product -- beer -- to liquors, many of which are imported, will have a significant impact on our nation's trade balance. About 2% of the nation's current trade deficit is due to the importation of foreign wines and liquors ... and "equalization" will just worsen this situation.

Ultimately, policy makers should be concerned about who is being taxed -- not what is being taxed. Beer is purchased primarily by moderate-income wage earners, while a larger proportion of other alcoholic beverage are purchased by higher income groups. Raising beer taxes relative to spirits would simply make the tax system more regressive. Where is the "equality" in a 400% tax increase on "Joe Six-pack" ... while the $20-a-bottle scotch drinker is left untouched? In very real terms, that would be the effect of "alcohol equalization."

HIGHER BEER TAXES WILL HURT THE BREWING INDUSTRY

In addition to unfairly singling out 80 million beer drinkers, the Staff Options to increase beer taxes would damage an overwhelmingly American industry:

Approximately 95% of all beer consumed in this country is produced by U.S. brewers who generate about 200,000 jobs in beer production, distribution and support industries (Weinberg & Associates, 1985). During the current decade, beer sales have at best grown at a very slow rate. Any excise tax increase large enough to help reduce the federal deficit would inevitably drive down sales and throw thousands of industry employees out of work.

CONCLUSION

The Committee on Ways and Means is faced with difficult deliberations in the weeks ahead. The members of the Beer Institute supported the Committee's efforts last year regarding Tax Reform.

And likewise this year, if higher taxes are needed, America's beer drinkers, and America's brewers, are prepared to do their part. Not as a separate group, singled out for discriminatory treatment. But rather, as a part of the total fabric of American society ... subject to the same fair and equitable treatment as all other citizens and corporations.

We fully support the spirit of Tax Reform ... and the fundamental principles which Tax Reform embodies. And we urge that these principles be carried forward in the Committee's decision-making on new taxes.

THE BEER INSTITUTE BREWER MEMBERS

- Anchor Brewing Company
  - San Francisco, CA
- Anheuser-Busch Companies, Inc.
  - St. Louis, MO
  - Fairfield, CA
  - Los Angeles, CA
  - *Fort Collins, CO
  - Jacksonville, FL
  - Tampa, FL
  - Merrimack, NH
  - Newark, NJ
  - Baldwinsville, NY
  - Columbus, OH
  - Houston, TX
  - Williamsburg, VA
- Boulder Brewing Company
  - Longmont, CO
- Buffalo Bill's Brewery
  - Hayward, CA
- Cerveceria India
  - San Juan, PR
- Cold Spring Brewing Company, Inc.
  - Cold Spring, MN
- Adolph Coors Company
  - Golden, CO
  - *Rockingham County, VA
- Eastern Brewing Corporation
  - Hammonton, NJ
- The Firestone-Fletcher Brewing Company
  - Los Olivos, CA
- G. Heileman Brewing Company, Inc.
  - La Crosse, WI
  - Perry, GA
  - Belleville, IL
  - Bransville, IN
  - Baltimore, MD
  - Frankenmuth, MI
  - St. Paul, MN
  - Portland, OR
  - San Antonio, TX
  - Seattle, WA
  - Milwaukee, WI
- Hibernia Brewing Limited
  - Eau Claire, WI
- Hope Brewing Corporation
  - Providence, RI
- Joseph Huber Brewing Company
  - Monroe, WI
- Jones Brewing Company
  - Smithton, PA
- Latrobe Brewing Company
  - Latrobe, PA
- Jacob Leinenkugel Brewing Company
  - Chippewa Falls, WI
- The Lion, Inc.
  - Wilkes-Barre, PA
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  - New York, NY
- F. X. Matt Brewing Company
  - Utica, NY
- Mendocino Brewing Company
  - Hopland, CA
- Miller Brewing Company
  - Milwaukee, WI
  - Irwindale, CA
  - Albany, GA
  - Fulton, NY
  - Eden, NC
  - Trenton, OH
  - Fort Worth, TX
- Old New York Brewing Company, Inc.
  - New York, NY
- Pittsburgh Brewing Company
  - Pittsburgh, PA
- Red Hook Ale Brewery, Inc.
  - Seattle, WA
- August Schell Brewing Company
  - New Ulm, MN
- Hudepohl-Schoenling Brewing Company
  - Cincinnati, OH
- Sierra Nevada Brewing Company
  - Chico, CA
- Snake River Brewing Company
  - Caldwell, ID
- Spoetzel Brewery, Inc.
  - Shiner, TX
- Stanislaus Brewing Company, Inc.
  - Modesto, CA
- Stevens Point Brewery
  - Stevens Point, WI
- Straub Brewery, Inc.
  - St. Mary's, PA
- The Stroh Brewery Company
  - Detroit, MI
  - Los Angeles, CA
  - St. Paul, MN
  - Winston-Salem, NC
  - Allentown, PA
  - Memphis, TN
  - Longview, TX
- Yakima Brewing & Malting
  - Yakima, WA
- D. G. Yuengling & Son, Inc.
  - Pottsville, PA

APPENDIX I
BEER INSTITUTE ASSOCIATE MEMBERS

Aluminum Company of America
Pittsburgh, PA
American National Can Company
Chicago, IL
American Flange & Manufacturing Co.
Linden, NJ
Anchor Glass Container Corp.
Tampa, FL
Angelus Sanitary Can Machine Company
Los Angeles, CA
Auscan Closures Canada, Inc.
Lasalle, Quebec, CANADA
Barry-Wehmiller Company
St. Louis, MO
John Barth, Inc., New York, NY
Beer Marketer's Insights
West Nyack, NY
Beverage Marketing Corp.
New York, NY
Bier-Drive GMBH, Milwaukee, WI
F. Bing, Inc., New York, NY
Brewing Systems, Inc.
Fort Walton Beach, FL
Briess Malting Company
New York, NY
Brockway, Inc., Brockway, PA
Continental Beverage Packaging
Stamford, CT
Diamond-Bathurst, Malvern, PA
John Eisenbeiss Corp.
New York, NY
J. S. Englert Company
Menlo Park, CA
Fleischman Kurth Malting Corp.
Minneapolis, MN
Foote, Cone, & Belding
Chicago, IL
Froedert Malt Corp.
Milwaukee, WI
Fromme, Mayer-Bass, Inc.
Yakima, WA
GAF Corporation, Wayne, NJ
Glidden Coatings & Resins
Cleveland, OH
W. G. Grace, Dewey & Almy Chemical Div.
Lexington, MA
A. Gusmer, Inc., Cranford, NJ
John I. Haas, Inc.
Washington, D.C.
H & K, Inc.
Waukesha, WI
Hops Extract Corp. of America
Yakima, WA
Illinois Cereal Mills, Inc.
Paris, IL
Illinois Tool Works, Inc.
Chicago, IL
KCS Industries, Milwaukee, WI
Kerr Glass Manufacturing Corp.
M.S. King, Inc., Larchmont, NY
Krause Milling Company
Ladish Malting Co., Milwaukee, WI
Longview Fibre Co., Longview, WA
Lupofresh, Inc, Wapato, WA
Manville Sales Corp.
Filtration & Minerals Division
Denver, CO
Meyer Supply, Inc., St. Louis, MO
Minesota Malting Co.
Cannon Falls, MN
Modern Brewery Age, Norwalk, CT
Nalco Chemical Company
Oak Brook, IL
A.C. Nielsen Company
Northbrook, IL
Nigrelli Systems, Inc., Kiel, WI
L. Oppenheimer & Co., New York, NY
Joseph L. Owades & Co.
San Francisco, CA
Owens-Illinois, Inc., Toledo, OH
Perlick Corporation, Milwaukee, WI
Prairie Malt Ltd.
Biggar, Sask., CANADA
Ragsdale Brothers, Inc.
Englewood, CO
Rahr Malting Co., Minneapolis, MN
Rapids, Inc., Cedar Rapids, IA
Reynolds Metals Company
Richmond, VA
Schreier Malting Co., Sheboygan, WI
George Segal Co., Inc.
Mamaroneck, NY
J. E. Siebel Sons Co., Inc.
Chicago, IL
Stauffer Chemical Company
Westport, CT
S. S. Steiner, Inc., New York, NY
Sunnyhops, Inc., Yakima, WA
Supreme Rice Mill, Inc.
Crowley, LA
Union Camp Corporation
Lancaster, PA
Western Hop Company, Inc.
Yakima, WA
Zapata Industries, Inc.
Frackville, PA

CHARLES E. BENNETT
MEMBER
3RD DISTRICT, FLORIDA

ARMED SERVICES COMMITTEE
CHAIRMAN OF SEAPOWER SUBCOMMITTEE
MEMBER OF PROCUREMENT SUBCOMMITTEE

MERCHANT MARINE AND FISHERIES COMMITTEE

CHAIRMAN OF FLORIDA CONGRESSIONAL DELEGATION

Congress of the United States
House of Representatives
Washington, DC 20515

RAMON L. DAY
ADMINISTRATIVE ASSISTANT

JODY H. MOONEY
LEGISLATIVE ASSISTANT

SHARON H. SIEGEL
BARBARA L. FETHEROLF
DARLA E. SMALLWOOD
RUSSELL W. HOUSTON
ETHEL M. SCHISSELL
MIRIAM E.A. WOLFF
SALLY A. GARRETT
GREGORY M. WILLIAMS
STAFF

WASHINGTON OFFICE
2107 RAYBURN BUILDING
WASHINGTON, DC 20515
TELEPHONE 202-225-2501

JOHN W. POLLARD, JR.
BRENDA C. DONALDSON
DONNA M. WELDON

JACKSONVILLE OFFICE
314 PALMETTO STREET
JACKSONVILLE, FL 32202
TELEPHONE 904-791-2587

July 15, 1987

Honorable Dan Rostenkowski
Chairman
Committee on Ways and Means
1102 Longworth HOB
Washington, D.C. 20515

Dear Mr. Chairman:

I recently became aware of an option for increasing revenue being considered by the Committee on Ways and Means. Specifically that proposal under Alcoholic Beverage Excise Taxes would repeal the reduction of the tax rate on alcohol content in distilled spirits that is attributable to wine or certain flavors. The effect of this proposal could put orange wine producers in Florida out of business — in that I am so advised by constituents whom I believe —

I respectfully request your carefully consideration of this proposal in light of its adverse effect on Florida. I appreciate your assistance.

With kindest regards, I am

Sincerely,

Charles Bennett

Charles E. Bennett

CEB/rwh

1423 East Washington Ave., Apt. 35
El Cajon, California 92019
July 24, 1987

Rep. Dan Rostenkowaski, Chairman
Ways and Means Committee
House Office Building
Washington, D.C. 20515

Dear Mr. Rostenkowaski:

An initiative is in order to increase the Federal tax from 16¢ to 65¢ on a six pack of beer, and from 3¢ a quart to 55¢ on wine.

The product destroying so many lives each year should provide more revenue for our deficit national budget.

Sincerely,

DUKE UNIVERSITY
INSTITUTE OF POLICY SCIENCES
AND PUBLIC AFFAIRS

PHILIP J. COOK, *Director*
Professor of Public Policy Studies and Economics

4875 DUKE STATION
DURHAM, NORTH CAROLINA 27706
(919) 684-6612 -684-2207

July 9, 1987

Robert J. Leonard
House Ways and Means Committee
Room 1102 Longworth House Office Bldg.
Washington, DC 20515

Dear Mr. Leonard,

I am requesting that this letter and the attached article be included in the official hearing record for the recent hearing on options for increasing federal revenues.

I am an economist, and have done extensive empirical research on the economics of alcohol abuse with particular focus on the liquor excise tax. Three conclusions have emerged from my research that are particularly relevant to the hearings: 1. There has been a substantial long term decline in the prices of alcoholic beverages relative to the prices of other goods and services. In part this decline is the result of the failure of the federal excises to increase with general inflation; 2. Increasing the price of liquor and other alcoholic beverages will save lives by reducing the cirrhosis mortality rate and the highway fatality rate; and 3. The alcohol excise tax is concentrated on the relatively small proportion of the population that drink heavily, which is of course the group that generates the bulk of alcohol related social costs. In that sense, this tax could be considered "fair."

Each of these points is developed in the enclosed article, "Increasing the Federal Alcohol Excise Tax," which was published in a National Academy Press book titled **Toward the Prevention of Alcohol Problems** (Dean R. Gerstein, editor).

I appreciate the opportunity to participate in the debate over this important issue.

Sincerely,

Philip J. Cook

PJC/bw
Enclosures

Toward the Prevention of Alcohol Problems

Government, Business, and Community Action

Dean R. Gerstein, *editor*

Summary of a conference held under
the auspices of the

Panel on Alternative Policies
Affecting the Prevention of Alcohol Abuse and Alcoholism

Commission on Behavioral and Social Sciences and Education

National Research Council

NATIONAL ACADEMY PRESS
Washington, D.C. 1984

3 Taxing and Spending

INCREASING THE FEDERAL ALCOHOL EXCISE TAX

PHILIP J. COOK, Duke University

Inflation and the Erosion of the Excise Tax

The prices of alcoholic beverages have been declining rapidly in recent years in comparison with prices of other consumer items. Consumer price index statistics indicate that since 1967 the real price of all alcoholic beverages has declined 27 percent. Distilled spirits have led the way with a 48 percent fall in price, followed by beer (25 percent) and wine (19 percent). The results of econometric and epidemiologic studies show that such reductions in relative price have the effect of promoting alcohol consumption and increasing the incidence of alcohol-related problems.

The fact that liquor prices are currently at about one-half of the 1967 level can be attributed in part to congressional inaction with respect to federal excise taxes on alcoholic beverages. Current federal excise tax rates were set in 1951 but have been largely repealed by inflation since then. If the federal tax had been indexed to the consumer price index in 1967, the cost of a fifth of liquor would currently be about $3.50 higher. Indexing the beer tax would have had a smaller but still substantial effect on beer prices. It can be argued that the failure of Congress to increase taxes in step with inflation constitutes the most important feature of federal government policy in alcohol abuse prevention during the past 15 years.

The recent wave of concern over mounting federal deficits has put the federal alcohol tax back on the national political agenda. There is an obvious parallel with the federal cigarette tax, which had also been left at its Korean War level—$.08 per pack—for 30 years and then was doubled by Congress in 1982. While the impetus for raising this tax was a concern with "revenue enhancement," the more important consequence will be to promote the public health by reducing smoking. Similarly, an important consequence of an increase in the alcohol tax would be to reduce alcohol abuse and its attendant personal and social costs. I summarize here the evidence on the preventive effects of alcohol taxes and then discuss the distributional and revenue impacts of a tax increase.

Alcohol Taxes and the Rate of Alcohol Abuse

Alcohol abuse is a major public health problem. There are roughly 75,000 alcohol-related deaths each year (Gerstein, 1981:205). Chronic heavy drinking is responsible for a large fraction of the more than 27,000 deaths each year due to liver cirrhosis as well as about 5,000 deaths classified as resulting from "alcoholism." The remaining alcohol-related deaths involve failures in judgment, attention, and physical coordination resulting from inebriation, including about 25,000 alcohol-related auto fatalities and a number of other accidents, homicides, and suicides. Alcohol-related morbidity and injuries impose a considerable burden on the health care system. A recent estimate (Schifrin, 1983) of health care costs stemming from alcohol-related problems is $20 billion for 1979—about 10 percent of total health care expenditures for that year. The cost of absenteeism and reduced productivity associated with employee drinking and premature death is even greater—roughly $78 billion in 1979 (Schifrin, 1983).

For alcohol taxes to be an effective policy instrument for reducing these and other costs associated with alcohol abuse, it must be true that higher alcohol prices reduce the prevalence of chronic heavy drinking and the incidence of drunkenness. An increase in taxes on liquor, wine, or beer results in an increase in the average prices of these commodities and a reduction in alcohol consumption from these sources. (More precisely, consumption is less than it would have been without the tax increase.) This result has been established quite conclusively for data from the United States and Canada (Johnson and Okanen, 1977; Ornstein and Hanssens, 1981; Cook and Tauchen, 1982). More important and controversial is the question of how taxes and prices influence the consumption levels of the heaviest drinkers. It is logically possible that average consumption would fall as a result of a tax increase solely due to its effect on moderate drinkers; the heaviest drinkers are immune to economic incentives. An argument supporting this possibility can be stated by a chain of propositions: (1) a large portion of the heaviest drinkers are alcoholics, in the sense that they are addicted to alcohol; (2) alcohol addicts will drink something like the biological maximum every day, practically regardless of the cost of obtaining their drinks; (3) therefore, it must be the more moderate drinkers who adapt their drinking practices to the price of alcoholic beverages.

This sort of argument may seem plausible to many. In reply, an economist would point out that a price increase has a greater economic impact on an alcoholic—who may already be spending a third or more of his or her income on alcohol—than on a moderate drinker, and that ordinarily this greater impact would be expected to yield, if anything, a greater response in consumption behavior. Furthermore, there is considerable clinical evidence that alcohol consumption by alcoholics is responsive to experimental manipulations of the costs of taking a drink (Mello, 1972; Nathan and Lisman, 1976). In any event, this issue can be better resolved through careful empirical analysis than through unsupported generalizations about the behavior in question.

The Effect of Alcohol Taxes on Cirrhosis Mortality Statistics on the prevalence of chronic heavy drinking are not widely available. However, there is a widely accepted proxy measure—the rate of deaths due to cirrhosis of the liver. These death rates have provided the basis for nearly all estimates of alcoholism prevalence rates (Seeley, 1960).

Most people who die of liver cirrhosis, especially after age 30, exhibit a history of chronic intense drinking: Schmidt (1977) found that 80 percent of all cirrhosis deaths in Ontario in 1974 were alcohol-related. The typical victim of alcohol-related cirrhosis has consumed an enormous amount of alcohol; Lelbach (1974) estimates that a primarily healthy, 150-pound person who drinks roughly 21 ounces of 86 proof liquor every day for about 20 years has a 50 percent chance of contracting liver cirrhosis. Thus, for any one individual, there tends to be a long lag between the onset of heavy drinking and the prospect of death from liver cirrhosis. The cirrhosis mortality rate is therefore not a direct indicator of the current fraction of alcoholics in a population, but does give a good indication of the fraction that has been drinking heavily for two or more decades. It should be kept in mind that the cirrhosis mortality rate is of interest in its own right, in addition to being a proxy

for the prevalence of alcoholism. Cirrhosis is among the leading causes of death in the United States, Canada, and most European nations.

Using this statistical indicator of the prevalence of chronic excess consumption, it is possible to explore the relationship between alcohol taxes and excess drinking. My first study of this relationship (Cook, 1981) was based on annual observations of 30 states for the 15-year period spanning 1960 to 1974. During this period there were 38 instances in which one of these states increased its liquor tax by a substantial amount (more than $.24 per proof gallon). I viewed each of these tax increases as a test case in a sort of "natural experiment." For each of these test cases, the percentage change in the state's cirrhosis mortality rate was calculated; the test statistic was defined as the mortality rate during the 3 years before the tax increase. The control groups for each of these test cases were the other states in the corresponding years. The result was that states that raised their liquor tax typically had a greater reduction (or smaller increase) in cirrhosis mortality than other states in the corresponding year (see Table 3-1). Indeed, 63 percent of all test cases were in the upper half of the distribution with respect to the test statistic—a result that would occur by chance alone with probability .072. This result is fairly strong evidence that the tax increase reduced the cirrhosis mortality rate, at least in the short run.

Why did some (38 percent) of the states with increased taxes experience a relative increase in cirrhosis mortality? My interpretation is that cirrhosis mortality fluctuates from year to year for a variety of reasons besides changes in liquor prices. In some of the test cases, these chance fluctuations happened to be positive and large enough to more than compensate for the consumption-suppressing effect of the tax increase. The fact that in most cases (63 percent) the state exhibited a relative reduction in cirrhosis mortality suggests that this effect does exist.

The principal challenge to the validity of this interpretation is that a state legislature's decision to raise the tax is influenced, directly or indirectly, by cirrhosis trends in the state. For example, if a sudden increase in cirrhosis mortality led to a tax increase and a natural regression to the cirrhosis mortality trend subsequently occurred, then the tax increase would be followed by a reduction in mortality but would not necessarily have caused it. This possibility is tested in Cook (1981) and Cook and Tauchen (1982). The evidence from these tests does not support this interpretation of my result—tax increases apparently *are* largely exogenous.

My quasi-experimental approach to studying the effect of liquor taxes on heavy drinkers has the virtues of simplicity and ease of interpreta-

TABLE 3-1 Effect of State Liquor Tax Increases on Cirrhosis Mortality Rates, 1960-1974

Rank Order	Number of Test Cases	Percentage of Test Cases
1–5	9	63.2
6–10	9	
11–15	6	
16–20	3	36.8
21–25	9	
26–30	2	

Note: For each year during the sample period, the 30 states are rank ordered with respect to percentage change in cirrhosis mortality rate. The state with the largest reduction is ranked first. States that raised their taxes were usually at the low end (with the greatest reductions) of this distribution in the year of the tax increase.

Source: Cook (1981 277)

tion. It does not generate a usable estimate of the magnitude of the effect in question, however. Primarily for this reason I undertook a second study (Cook and Tauchen, 1982), which applied an estimation technique (analysis of covariance estimated by generalized least squares regression) to annual data from the same 30 states for the period 1962-1977. Before undertaking this task, we refined the annual state-level cirrhosis mortality data; our variable was the age-adjusted mortality rate for state residents ages 30 and over. Our principal result can be stated this way: other things being equal, a $1 per proof gallon increase in a state's liquor tax will reduce the state's cirrhosis mortality rate by 1.9 percent in the short run. (The tax variable in the regression was adjusted for inflation, as measured by the consumer price index. The statement of our results given here is converted to October 1981 dollars.) The 95 percent confidence interval for this estimated reduction is 0.4-3.5 percent; thus our parameter estimate is statistically significant by the usual standards of social science. Our parameter estimate suggests further that the tax effect is far from trivial—according to this estimate, a doubling of the U.S. federal liquor tax would reduce the nation's cirrhosis mortality rate by a figure in the neighborhood of 20 percent.

Given the normally long lag between the onset of heavy drinking and death from cirrhosis, it may not be obvious how an increase in the liquor tax could cause an immediate reduction in cirrhosis mortality. The reason is that the cirrhotic process is interruptible—if at any time an alcoholic should stop drinking, his or her liver would cease to deteriorate. If the rate of consumption slows, then the deterioration process also slows. At any one time, there is a reservoir of people who are within one year of death from cirrhosis at their current rate of consumption. If some of them reduce their consumption in response to a tax increase, then not all of them will die in that year—i.e., the mortality rate will decline in the first year. What about the trend in mortality over the long run? The mortality rate will gradually decline after the initial drop, as the size of the reservoir gradually shrinks. The total effect of the tax increase will not be realized for many years, but clearly the ultimate reduction in mortality rates due to such an increase will exceed the initial reduction. Thus, our figures underestimate the full effect.

In conclusion, there is considerable statistical evidence that a liquor tax increase causes an immediate and substantial reduction in cirrhosis mortality. If cirrhosis mortality rates are a reliable indicator of the prevalence of alcoholism, then it can be inferred that alcoholics' drinking habits are quite sensitive to the price of liquor.

The Effect of Liquor Taxes on Auto Fatalities There is also some direct evidence that accident rates are responsive to changes in the liquor tax. I tested the effect of state liquor tax increases on the auto fatality rate in my 1981 paper, using the same sample and technique as those in the cirrhosis study. Between 1960 and 1974, most of the states (25 of 38) that increased their liquor tax subsequently experienced a below-average change in auto fatality rates relative to states that did not increase their tax.

Unfortunately there is no comparable evidence on the effect of beer prices on auto fatalities. Beer is particularly important because it is the beverage of choice for the demographic group posing the greatest risk on our highways—young people.

Conclusion Available evidence suggests that increases in alcoholic beverage taxes cause reductions in per capita consumption, consumption by chronic heavy drinkers, and the incidence of drunken driving. It seems safe to conclude that the sharp decline in alcohol prices during the last 15 years has exacerbated alcohol-related public health problems. Fortunately there appear to have been countervailing forces at work during this period, such as increased emphasis in the popular culture on health and fitness, that have prevented a large increase in drinking from occurring. Indeed, adult per capita consumption has changed very little since 1970. If alcohol prices had kept pace with inflation, the per capita consumption would probably have declined substantially during this period.

Equity Considerations in Alcoholic Beverage Taxation

Alcohol control policies, including taxation, have been criticized by some as excessively blunt instruments, reducing the enjoyment of the many for the sake of curtailing the alcohol-related problems suffered by the relatively few. In the imagery of Gusfield (1976:275), these policies fall "like sober rain from heaven upon the problem and problem-free drinkers alike." There are two comments to be made in response to this critique.

First, much of the social cost of excess drinking also falls on "the problem and problem-free drinkers alike," as well as the abstainers. Our government social insurance tax rates and private auto and health insurance premiums reflect, in part, the costly consequences of alcohol abuse. The drunk driver puts all of us at increased risk of an injury or death on the highway. Thus, it can be argued that an effective alcohol control measure will indirectly benefit the problem-free drinkers (as well as those who abstain) by reducing the collective costs generated by problem drinking.

Second, the direct costs of alcohol control measures such as taxation are more or less proportional to the amount of alcohol an individual consumes—the "sober rain" falls on all drinkers, but with much greater intensity on the chronic heavy drinkers than on others. In the United States it is estimated that the heaviest-drinking 10 percent of the adult population consumes about 57 percent of all beverage alcohol sold each year (Gerstein, 1981:193). To the extent that alcohol taxes are proportional to ethanol content, then, this top group of drinkers will also pay 57 percent of the taxes. Thus, the relatively small group of drinkers who have the highest incidence of alcohol-related problems also pays the bulk of the alcohol taxes.

To summarize, alcohol taxes, if effective in reducing the costly consequences of excess consumption, reduce the burden alcohol imposes on society at large. Furthermore, whether or not alcohol taxes are effective in reducing the costly consequences of excess consumption, they have the characteristic of exacting payment in proportion to consumption and hence (very roughly) in proportion to the social costs generated by their consumption. If we believe that the drinker should pay (at least in an actuarial sense) for the social costs related to his or her drinking, then the excise tax on alcohol is reasonably efficient.

A second equity issue concerns the burden imposed on poor households by alcohol taxes. Such taxes are of course not adjusted to the household's ability to pay (as is the income tax), and by a traditional measure alcohol taxes appear regressive. However, it is certainly possible that an increase in alcohol taxes will actually prove beneficial to the children of the heavy drinkers in poor families. For example, if a household's demand for alcoholic beverages is elastic (price elasticity greater than 1.0), an increase in price will cause a reduction in total expenditures on drinking, thereby leaving more money for other household expenditures. Surely poor households vary considerably with respect to price elasticity of demand. However, the available evidence suggests that the average household's demand for liquor is quite elastic; furthermore, poor households would tend to be more elastic than higher-income households. Therefore, for some fraction of poor households, an increase in alcohol tax rates would reduce expenditures on alcoholic beverages. And, it is quite possible that a tax-induced reduction in

TABLE 3-2 Revenue Effects of Changing Federal Alcohol Excise Taxes: Proportional Increases

	Current		"Doubling" Option		"Restore to 1951 Levels" Option[a]	
	Excise Tax Rate	Tax Collections[b] (billions)	Tax Collections Zero Elasticity (billions)	Tax Collections Unit Elasticity (billions)	Tax Collections Zero Elasticity (billions)	Tax Collections Unit Elasticity (billions)[c]
Liquor (86 proof fifth)	1.81	3.94	7.89	6.35	14.86	8.90
Beer (six-pack)[d]	.16	1.49	2.98	2.82	5.61	4.84
Wine (gallon, 12% alcohol)[e]	.17	.21	.41	.41	.78	.76
Increase in revenues		0	3.64	3.94	15.62	8.86

[a] The price level in March 1983 exceeded the 1951 price level by a factor of 3.77.

[b] From 1979.

[c] These calculations assume that the own price elasticity of demand is unity for all three beverage types, with zero cross-price elasticities. Assumed prices were $7.50 per fifth for liquor, $2.80 per six-pack, and $8 per gallon of wine.

[d] The federal excise tax on beer is $9 per 31-gallon barrel, implying a $0.16 tax per 72-oz. six-pack.

[e] Wine tax rates are higher for fortified and sparkling wines.

consumption by heavy drinking household heads may benefit other family members insofar as reduced drinking yields improved health and higher earnings.

Federal Revenues and Tax Rates

Currently federal excise tax collections on alcoholic beverages are about $6 billion. Table 3-2 provides estimates of the revenue effects from increasing excise tax rates uniformly on all three beverage tax rates. For example, if Congress were to double alcohol excise taxes (as they did cigarette taxes in 1982), a reasonable estimate of the revenue increase is $4 billion in the first year. The assumption behind this estimate is that the demand function for each beverage type is characterized by a constant elasticity of 1. (Revenue estimates for beer and wine are not sensitive to changes in this assumption.) Under the same assumption, revenue would increase by about $9 billion if Congress were to return alcohol beverage tax rates to 1951 levels in real terms.

Instead of increasing all three excise tax rates proportionately, Congress might be well advised to standardize tax rates per ounce of ethanol across all beverage types. Under the current tax structure, liquor is taxed at $.164 per ounce of ethanol, whereas the tax on beer is equivalent to about $.057 per ounce, and table wine about $.011 per ounce. Raising beer and wine taxes to the level of the liquor tax would bring in more revenue than doubling all tax rates and would have the important advantage of giving official recognition to the principle that ethanol is the problem agent, regardless of the type of beverage in which it is contained.

Conclusion

The decline in the real value of the U.S. federal excise taxes on alcoholic beverages has benefited heavy drinkers in some ways but has had the effect of increasing the prevalence of alcoholism and its attendant costs. Raising the excise tax would be a rather well-targeted response to the social burden that heavy drinkers as a group impose on the rest of society. There are a number of alternatives for reducing the U.S. budget deficit. Few of them have the substantial beneficial side effects that would result from raising the alcohol excise tax rates.

COMMENTS OF

HONORABLE RON DE LUGO
MEMBER OF CONGRESS

Mr. Chairman,

I am grateful for the opportunity to address this committee as it considers revenue generating options for balancing the federal budget. I am particularly concerned about the proposed option to increase the excise taxes on distilled spirits. I am not here to oppose the proposal, but to urge the committee to remove or modify the restrictions that have been placed on the cover-over mechanism of Internal Revenue Code Section 7652 in order to eliminate the unfair effects that the restrictions have had on my district, the Virgin Islands.

Prior to the 1984 Tax Act, all internal revenue taxes imposed on products manufactured in the Virgin Islands were covered-over to the treasury of the Virgin Islands pursuant to Section 28(b) of the Virgin Islands Revised Organic Act. The excise tax rebates to the Virgin Islands have their historical origins in the 1916 decision by the Congress that it was "but just and fair" to return to Puerto Rico the manufacturing excise taxes on products produced there and shipped to the U.S. The same judgment was reached with respect to the Virgin Islands in 1954, with the proviso that the Virgin Islands was prohibited from levying its own taxes on such products.

Since its inception, the excise taxes collected on rum distilled in the Virgin Islands and sold in the United States have been an integral part of the territory's planning and budgeting process. The excise taxes have been utilized for major capital improvement projects; such as, schools, roads, sewer and other basic infrastructures.

The excise tax rebates account for about 15% of the territorial budget. However, since 1983, the Virgin Islands have experienced a 20 % decrease in rum excise tax revenues. The decrease is partially attributable to the 1984 increase in excise taxes, which cut the demand for V.I. rum while at the same time capping the amount of excise taxes covered-over to the territorial treasury.

As part of the 1984 Tax Act, Congress increased the excise tax on distilled spirits from $10.50 a proof gallon to $12.50. Your committee, Mr. Chairman, and the House of Representatives supported our position that the full amount of the tax should be covered-over to the territories. However, the Senate decided and prevailed in conference that the proceeds from the increase in the tax would be covered into the U.S. Treasury rather than the territorial treasury. That decision was contrary to the long standing federal-territorial fiscal relationship that all excise taxes collected on products manufactured in the territory be rebated to the territorial government. The Act, in effect, for the first time, subjected a product manufactured in the territory to direct U.S. taxation.

But more importantly, the decision not to extend the entire increase in the excise taxes to the territory has had a dramatic impact on the local treasury. The increase in the excise taxes has resulted in reduced demand for distilled spirits. Industry figures show that last year alone, rum suffered a 7.2% decline in consumption, approximately one million cases. In the Virgin Islands, the decline in national consumption since enactment of the excise tax increase has translated into a drop of 16% in Virgin Islands rum shipments to the United States from 3.2 million proof gallons in 1984 to 2.9 million in 1985 and 2.7 million in 1986.

Because of the legislative cap on the cover-over provision imposed as part of the 1984 excise tax increase, the decline in Virgin Islands rum shipments has resulted in a corollary decline in territorial revenues. While V.I. excise tax collections averaged approximatly $35 million a year between 1980 and 1983, collections dropped to $31.6 million in 1984 (the first year of duty-free competition from CBI eligible countries), and declined further to $30.4 million in 1985 and $28.6 million in 1986. I therefore submit that any further increase in the excise taxes without a corresponding change in the limitation imposed on the cover-over provision will continue to have a dramatic negative impact on the territorial government's ability to balance its budget and to meet the demands for much needed basic capital improvement projects.

Although I understand and support the need to balance the federal budget, I submit that it should not be done in an unfair and inequitable manner. The legislative history of the excise tax on distilled spirits produced in the territories indicates that the tax was never intended to be used as a source of raising revenues for the U.S. Government. To continue to utilize the excise tax that rightfully belongs to the territorial government as a means to balance the federal budget would fly in the face of clear Congressional intent and the long standing federal territorial relationship.

I submit that any increase in the excise tax must and should be accompanied by a simultaneous elimination of the unfair restrictions on the cover-over provision. While the effect of the elimination would be de minimus to the U.S. treasury, it would have a dramatic impact on the Virgin Islands treasury. The local government would once again be able to plan and adequately meet its capital improvement objectives. Elimination of the restriction would once again bring the federal government into compliance with the legislative history and Congressional intent of the cover-over provisions of Internal Revenue Code Section 7652.

Once again, I thank this committee for the opportunity to present my views on the proposal to increase the excise taxes and ask that the position submitted by me and the Governor of the Virgin Islands on behalf of the people of the Virgin Islands, that the restriction on the cover-over provision be eliminated, will be favorably viewed by this committee.

TESTIMONY OF F.A. MEISTER, PRESIDENT/CHIEF EXECUTIVE OFFICER, DISTILLED SPIRITS COUNCIL OF THE UNITED STATES

Mr. Chairman and Members of the Committee:

I am F.A. Meister, President and Chief Executive Officer of the Distilled Spirits Council of the United States (DISCUS), a trade association made up of approximately 90 percent of the manufacturers and marketers of distilled spirits. I am here to join with the beer and wine industries in opposing any increase in the excise tax on beverage alcohol. The beverage alcohol industry pays $5.5 billion annually in federal excise taxes and an additional $7 billion annually in state and local taxes. These excise taxes are among the most regressive of all federal taxes imposed on any product. Any increase in federal beverage alcohol taxes will go a long way toward offsetting all the savings to low and middle income Americans contained in last year's tax reform bill. One of your colleagues, Jim Chapman from Texas, has quoted a January CBO study that "shows a $19 billion increase in excise taxes ... would cost the working poor more than double the savings they received under tax reform."

Our industry is strongly opposed to any further increase in the tax on distilled spirits. The tax on our product was just recently raised--in October, 1985--by $2.00 a gallon. The tax went up 19%--from $10.50 to $12.50 per proof gallon.

It is unfair to single out a struggling industry for tax hikes every time Congress struggles with the deficit. The 1985 tax hike hit our industry hard. Prior to the tax hike (FY 1981-'84) our sales declined 1.8% annually. Since the October 1985 tax hike, the decline in apparent liquor consumption quickened. As a result, excise tax collections did not meet Joint Tax Committee expectations. In fact, they were $670 million less than the Treasury and the JTC estimated for fiscal 1986. This is because (1) government assumed we were growing at 1.1% annually when in fact we were declining by 1.8% annually, and (2) government significantly underestimated the decline in consumption that would follow the 19% FET increase.

The situation was summarized recently by Stephen E. Higgins, Director of the Bureau of Alcohol, Tobacco and Firearms. He noted that after the 19% FET increase, shipment of spirits dropped 13% and that FET revenues rose only 3%.

While Fiscal Year 1987 may see a relative increase in federal spirits revenues, the impact of the tax hike on our industry was devastating. In calendar year 1986, spirits sales fell 5.8%, a decline in producer value of $300 million (exclusive of the FET). Spirits imports into the U.S. were down even more, 10.5%. Domestic capacity utilization declined 4 percentage points below 1985 levels. Industry-wide employment fell 5.4%, and manufacturing employment, that is our industry's blue collar jobs, dropped 6.6%.

As these dramatic decreases illustrate, we simply cannot stand another tax increase. In today's language, people refer to excise taxes as "sin" taxes, "externality cost" taxes, "abuse" taxes, and so on and so on. The simple fact of the matter is that whatever the word, excise taxes on liquor already are excessive and regressive.

A seductive but fallacious argument proposed by anti-alcohol groups is that increasing liquor taxes will decrease alcohol abuse problems. While excessive liquor taxes already are having a substantial negative impact on sales, it is not true that alcohol abuse problems will be reduced by even higher taxes:

1. Research clearly shows that alcohol abusers are those least likely to reduce alcohol consumption.

   The National Highway Traffic Safety Administration has stated that the majority of the alcohol related fatal crashes are caused by heavy problem drinkers who have on average had about fifteen drinks before driving. These are not the people whose drinking will be deterred by the price of alcohol.

   In their comprehensive 1983 review, "Alcohol Problems and Alcohol Control in Europe", Dermot Walsh, Director of Mental Health, Medical Social Research Board, Dublin, and Phil Davies, Research Scientist for the University of Aberdeen, Scotland, reviewed the experience of all European countries in this connection. They found that Sweden, which has imposed burdensome taxes and sharply increased prices on alcohol, has experienced growing rates of admissions to alcoholism treatment and drunk driving convictions. Proponents of the misuse of taxes for social policy reasons would have us believe that such measures would decrease alcohol abuse problems, but this has clearly not been the case.

2. Numerous experts on tax policy have stated repeatedly that the tax code is not the vehicle by which public morality should be dictated. The tax code should be based on revenue policy considerations, not social engineering goals.

3. High excise taxes on liquor unfairly penalize the vast majority of drinkers who are moderate and responsible and who do not in any way abuse alcohol.

4. Excessive excise taxes clearly are penalizing the liquor industry to the point that tax policy will drive our industry substantially out of business while promoting illegal production.

   In 1985, a two-day conference on "Alcohol Use in Latin America," sponsored by Brown University's Center for Latin American Research Director, Human Relations Research, located in Providence, RI. In this report, the author, Anna Cooper Heath, presented findings that controls over the production of alcohol beverages in Latin America has met with little success and indeed has often let to "moonshining" as a " . . . major cottage industry in many parts of Latin America." The report also states that "indexed pricing and heavier taxation . . . seems unlikely to affect those who habitually drink the most."

There is a limit to how much tax our industry and its consumers can bear. Recent experiences in other countries have demonstrated that punitive levels of spirits taxation can adversely affect public revenues which depend on steady or climbing consumption. In Australia, Canada, Denmark, Germany, Ireland, Japan, the Netherlands, and The United Kingdom projected revenue gains from spirits tax hikes were far off the mark. In fact, revenues actually declined in Denmark following a 37.5% tax increase. In Ireland, the government saw revenues fall by some 20% following a series of tax hikes. As a result, Ireland reduced its spirits tax by 20% as of October, 1984. In the United States, we are at that point of diminishing returns.

I hardly need to belabor the point that excise taxes are regressive. They are--hitting hardest at low and middle income people. They place a larger burden on those least able to pay. A recently released Peat Marwick study shows that the beneficial effects of the Tax Reform Bill for low and middle income people would be more than offset by excise tax increases on gasoline, tobacco, beer, wine and spirits. In fact the net effect would be to increase taxes on low income families by well over a billion dollars. It makes no economic sense to cut progressive taxes in one year and then substantially raise regressive taxes the next year.

Our industy's suffering translates into plant closings, job layoffs, and major job losses at the retail level where, of the 282,000 licensees who sell distilled spirits--two-thirds are mom-and-pop operations with four or fewer employees. Between 1978 and 1984, 28% of the liquor manufacturing jobs were lost. 1985 and 1986 saw a further 12% job loss.

Excise taxes are a traditional revenue source of the states. To the extent that federal excises are raised, states are deterred from tapping that source. Thus, in the past, the National Governors' Association has opposed federal excise tax hikes and President Reagan's original New Federalism proposal would have eliminated federal excise taxes entirely. Likewise, the National Conference of State Legislatures is on record as opposed to increases in federal excise taxes. States have been extremely active in raising excise taxes. State and local revenues from beer, wine and spirits are up by over 700% since 1951. From 1980 through 1987 there were 70 state tax increases on spirits. As a result of sales drops occasioned by the FET increase, we estimate state revenue collections may be off by $100 million.

The Revenue-Options pamphlet includes a provision which would index federal excise taxes. Such a provision would place costly administrative burdens on small retail and wholesale dealers in spirits. The Canadian experience with indexing taxes is instructive. Between April 1981 and September 1984, the Federal alcohol excise tax in Canada was automatically indexed to changes in inflation. The indexing policy had the following effects:

1. Federal spirits taxes were raised five times for a total of 53.7%.
2. Retail spirits prices increased almost 50%.
3. Spirits sales fell 15%.
4. 3,200 jobs were lost.
5. Revenue gains from the first three tax rate increases were totally offset by tax collection losses related to reduced consumption, by losses in personal and corporate income taxes and by welfare transfers.

Because of the unequivocal failure of the policy, the system of indexing was terminated in May 1985!

It makes no financial sense for the federal government to approve a proposal which, in the final analysis could result in less, not more revenues to the federal government. What is the logic and fairness of imposing an indexing proposal on just a few industries? It defies logic to index an already regressive consumer tax.

Yet another proposal would tax wine, and alcohol derived from flavors, at the distilled spirits rate when the wine, for example, is mixed with a distilled spirit to produce certain products. The wine does not become distilled; it remains wine. It is my belief that at whatever rate the Congress taxes wine or flavors it should not discriminate and necessarily raise that rate just because the wine or flavor is mixed with distilled spirits. The tax on wine or the alcohol in a flavor should be the same no matter who uses it, a bakery, a homemaker, or a distiller. The inequity of this proposal will adversely affect not only the distilled spirits industry, but also the wine and flavor industries.

That Congress always has taken this view is demonstrated by the fact that when what is now section 5010 of the Internal Revenue Code was accidentally repealed in the unamendable Trade Act of 1979, the section was retroactively reenacted in 1980.

The Revenue pamphlet also contains an option to eliminate the deductibility of alcohol advertising expenses. Such a provision would be a radical departure from the well-established rule of tax policy that ordinary and necessary business expenses can be deducted. Advertising is recognized as an important means to provide consumers with the information they need to make informed purchasing choices. Elimination of deductibility on alcohol could reduce consumer information. As the pamphlet points out in its arguments against this provision, "It is inappropriate to use discriminatory tax provisions to deal with non-tax issues involving alcohol and tobacco." The Distilled Spirits Council strongly opposes this limitation on advertising expenses for alcohol as well as the across-the-board limitation on advertising expense deductibility.

In summary, the liquor industry is traditionally seen as an easy political hit--a bottomless pit of money. That is not the case. We are a major and a legitimate industy--providing jobs and, indeed, 7 billion dollars of revenue annually to the federal, state and local treasuries. Like all industries, we feel the ebb and flow of economic tides. And for a number of years we have felt only the ebb. Consumer sales are the lowest per capita in twenty years. We are at a low point.

We do not ask for special treatment. We already pay more than our fair share. And just a year and a half ago you increased that share. There is a limit to our ability to pay. We believe that limit has already been reached in the spirits industry. That limit has already been passed.

Thank you for your consideration.

Elizabeth H. Garcia
12201 S.W. 109th Avenue
Miami, FL 33176

14 August 1987

The Honorable Dan Rostenkowski
U.S. House of Representatives
Washington, D.C. 20515

Dear Congressman Rostenkowski:

I am very disturbed about the possibility that Congress will raise the excise taxes on beverage alcohol.

I'm in the distilled-spirits business and have already seen the damage done to the spirits business by the 19% tax increase that took effect in 1985. Liquor sales were down 5.3% in 1986. We cannot stand another tax increase.

Excise taxes are regressive. Therefore, I urge you to vote against an increase in excise taxes on beverage alcohol.

Respectfully,

Elizabeth H. Garcia

Elizabeth H. Garcia

52 Musket Trail
Simsbury, CT 06070
July 22, 1987

Mr. Dan Rostenkowski
House Ways and Means
2111 Rayburn HOB
Washington, D.C. 20515

Dear Mr. Rostenkowski,

Re: Proposed Distilled Spirits Federal Excise Tax Increase

Distilled Spirits cannot afford another Federal Excise Tax increase for the following reasons:

(1) THE INDUSTRY IS IN TROUBLE

(a) Since the October 1, 1985 19% federal excise tax (FET) increase in spirits, sales are off 7% and spirits imports are down 15%.

(b) As a result of falling sales, FY86 federal tax collections after the 1985 tax increase have fallen $670 million short of the original Joint Tax Committee estimates. State revenue collections may be off $100 million as a result of sales drops occasioned by the FET increase.

(c) In 1986, there were 8.7% or 16 fewer distilled spirits bottlers and producers than in 1978. Worse yet, 28% of the 1978 liquor manufacturing jobs were lost by 1984 and 1985 saw a further 5.4% job loss.

(d) The sales drops translate into job losses at the retail level where, of the 282,000 licensees who sell alcohol, two-thirds are "mom and pop" operations with four or fewer employees.

(2) EXCISE TAXES ARE AN EXTREMELY REGRESSIVE FORM OF TAX...falling disproportionately on low to moderate income groups.

(a) A major of spirits (54%)/wine (51%)/beer (57%) drinkers fall into the low and moderate income groups.

(3) EXCISE TAXES ARE A TRADITIONAL REVENUE SOURCE OF THE STATES

(a) State and local revenues from beer/wine/spirits are up by over 700% since 1951. From 1980 to 1986, there have been 65 state tax increases on spirits.

(4) BEVERAGE ALCOHOL ALREADY PAYS MORE THAT ITS FAIR SHARE OF TAXES

(a) The industry pays the usual corporate/income/other sales taxes.

(b) The industry paid an additional $5.6 billion to the federal government in FY86 and $6.9 billion to state and local coffers in FY84.

Very truly yours,

Bill Guiel

William L. Guiel

As a consumer of alcoholic beverages, I am against unfair taxation.
Our country was founded because of such taxes

JULY 15TH - 1987

The Honorable Dan Rostenkowski
Chairman, Ways and Means Committee
U.S. House of Representitives
1102 Longworth House Office Bldg.
Washinghton, DC 20515

Dear Representative Rostenkowski:

As a fellow Illinoian, I am becoming increasingly concerned about the balooning budget deficits, and the escalating alcohol drug problems. You and your committee can take one action that will help amelionate both problems: raise the takes on all alcoholic beverages, particularly ~~on~~ wine and beer, which have been at the same rates since 1951! With this constant rate since 1951, It is obvious to realize ~~the~~ billions of dollars of lost revenues to the Treasury during the past 2 decades (considering the effect of inflation on a set rate).

Most alcohol tax is, and would be, paid by a small minority of heavy drinkers who are also responsible for much of the damage (personal and societal) related to alcohol abuse. Higher taxes and prices (alcohol beverages are now historically cheap compared to other consumers goods) would help to discourage excessive drinking, particularly among young people, and reduce alcohol problems. And the treasury would greatly benefit as well!

I hope you will propose and support raising taxes on alcoholic beverages.. to reduce the deficit and to improve the health and well-being of America.

Please inform me of your views.

most sincerely,
Matthew Haag
509½ S. Cherry St.
Freeport, IL 61032
Matthew S Haag

July 8, 1987

Committee on Ways and Means
Chairman Dan Rostenkowski
1114 Longworth House Office Bldg.
Washington, D.C. 20515

Dear Mr. Rostenkowski:

This is to urge you to support efforts to increase taxes on beer and wine. Not only would this increase federal revenue, but may help to reduce the demand for these alcohol products.

Contrary to what the alcohol industry lobbyists may tell you, having higher priced alcohol products is not a bad thing. As a professional working in the drug and alcohol field, I have learned that approximately 10% of the U.S. drinking population consumes about half of all the alcohol on the market. This suggests that half the alcohol sold in this country is being consumed by heavy drinkers, in other words, people who are prone to develop alcohol problems. If these people are going to go on drinking a disproportionate amount of alcohol, they may as well help to pay the cost this country bears in lost productivity, traffic deaths and injuries, health problems and broken families.

Please give this issue careful consideration and then raise the taxes on these products. If the taxes are increased, it will be for the first time since 1951!

Sincerely,

Lawrence D. Harrison
236 Linden Dr.
Trappe, Pa. 19426

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September 1, 1987

Honorable Dan Rostenkowski
Chairman, House Ways and Means Committee
U. S. House of Representatives
Washington, DC 20515

Dear Senator Rostenkowski,

I wish to add my voice to those in favor of increased excise tax on Alcoholic beverages. There is no doubt that the abusers of this product assess a monstrous 'tax' on the entirety of society, much of which can only be measured in human misery.

It is way past time that all of those who use the product share the toll. In some small way the increased tax may offset the associated costs to the public.

Heaven knows we can use the money to lighten the tax burden on every area of society.

Your support for the tax will be appreciated.

Sincerely,

George E. Priest, FLMI, CLU
Senior Vice President
Management Information Services

GEP/dlz

ICPA
INTERNATIONAL COMMISSION FOR THE PREVENTION OF ALCOHOLISM AND DRUG DEPENDENCY
6830 Laurel Street, N.W., WASHINGTON, D.C. 20012-2199 U.S.A. • Tel. (202) 722-6729 • Telex: 440-186

July 31, 1987

The Honorable Dan Rostenkowski, Chairman
House Ways and Means Committee
U.S. House of Representatives
Washington, DC 20515

Dear Mr. Chairman:

This letter is one to encourage you to look with favor upon raising the federal excise tax on this nation's number one beverage--alcohol!

These United States can no longer afford the luxury of this economic hardship placed upon its citizens due to the unrealistically low excise taxes on these beverages.

At the catastrophic annual rate of 120 billion dollars of economic loss to our country per year, one stands appalled by such waste. This type of insane nonsense will sooner or later bankrupt and impair all of us.

It's time for responsible individuals such as yourself to bite the bullet on this issue, and send a clear message to the American people and the liquor interest, the party's over! Why, if you folks in government would just equalize the taxes on beer, wine, and hard liquor, the government would raise an additional 4.7 billion dollars in revenues each year. This is to say nothing of the overall good to the American people. Perhaps you should consider doubling or tripling the excise taxes of alcoholic beverages over the next three years. Simple math tells us, as the excise taxes increase, the economic hardship on our government decreases, and the health impact of such a move would benefit all the citizens of our land, to say nothing of the increased funding available for preventive education measures.

Regional Blocs — Australia, Europe, Southern Asia, Middle East, Far East, South America, Trans Africa, North America

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Johanes Virolainen, Finland
Assistant to Executive Director
DeWitt Williams, E.D., USA

Just think of all the grass roots good you could accomplish, why you may even encourage the liquor giants to begin producing non-alcoholic beverages--they are able to do that, you know--and we would all benefit if that happened.

By the government's increasing the liquor excise tax, you would indirectly put a major dent in this nation's violent crime wave which in turn would tend to alleviate some of the overcrowding situations in our nation's prisons. Indirectly, you would effectively curtail the demand for illegal drugs, since alcohol is the world's gateway drug for ninety-four per cent of the drug users.

Less crime, happier families, safer communities, reduced court caseloads, less deaths--why, you could strike a blow for Truth, Justice, and the American Way, that would have a ripple effect on the health, welfare, social, and religious fabric of our national society.

My, if I had that type of opportunity--to bring about that much good into the lives of the American public--I certainly would bend all of my efforts and energies to see that it became a reality. What do you say?!?

Let's do the Right Thing for a change, and bring about a healthier climate in these United States. Let's not let Russia capture all the headlines on the issue of alcohol and economic loss to their government. Help put America back of the Right Track!!!

Sincerely,

T.R. Neslund
Executive Director-elect

bp

All Brand Importers, Inc.

20 Tower Lane, Avon Park South, P.O. Box 1630, Avon, Connecticut 06001
Telephone: (203) 677-2223 • Telex: 215827 • Facsimile: (203) 674-9230

John J. Kucich
Chairman and Chief Executive Officer

July 10, 1987

The Hon. Dan Rostenkowski
House Ways and Means Committee
U.S. House of Representatives
Washington, DC 20515

Dear Congressman Rostenkowski:

I am an employee of All Brand Importers, Inc., a major importer of beer, and Heublein, Inc., a producer and marketer of distilled spirits. I am very concerned because, once again, Congress may be looking at raising excise taxes on liquor. I urge you to oppose such a tax hike.

Congress just recently approved a 19% tax increase on spirits to help reduce the deficit. It is not fair to single out liquor for tax increases every time the deficit reduction problem comes before Congress.

Our industry is already in trouble and employment is shrinking every year. There is a limit to how much tax our industry can bear. Please vote no on any liquor tax increase

Sincerely,

John Kucich

John J. Kucich

Similar letters were received from the following, all employees of Heublein, Inc.:

Ms. Irene Bengston, New Britain, Connecticut
Mr. Alastair G. Clark, Hartford, Connecticut
Ms. Marjorie Fiaschetti, Glastonbury, Connecticut

Mr. Bruce D. Miller and Ms. Beth Anne Miller, Unionville, Connecticut
Mr. Martin K. Mogensen and Ms. Marlene Mogensen, West Hartford, Connecticut

2648 Baronne
Springfield Illinois
July 27 1987

Representative Dan Rostenkowski
Chairman House Ways and Means Committee
House of Representatives
Washington, D.C. 20515

In favor of raising Federal Excise taxes on beverage alcohol, I would point out that an increase in liquor taxes in 1985 is the only increase since 1951, and that increase did not include beer and wine.

Doubling liquor taxes, and then, equalizing the rate of tax on the alcohol in beer and wine as proposed by the National Alcohol Tax Coalition would produce about 12 billion dollars in additional federal revenue

Beer and wine taxes are less than 1/4 of what they were at the repeal of Prohibition, and the tax on liquor is about 25% less.

Twelve Billion dollars would pay the combined annual costs of the National Institute on Alcohol Abuse and Alcoholism, the Administration on Aging, the juvenile justice and child abuse state grant programs, and the federal food stamp program.

Respectfully submitted,

Frances G. Laird
2648 Baronne
Springfield Illinois
62704

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Idaho Falls, Idaho 83401
(208) 523-7378

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16 Aug 1987

Dear Senator Dan Rostenkowski,

I favor an increase in the federal excise tax on beer and wine.

It is a product that certainly is not a necessity. In fact alcoholic drinks cause a lot of unessary expense in society by causing higher insurance rates, damaging health, causing the destruction of family through divorce ~~child~~ and child abuse, killing innocent people on our hiways, and a loss of productivity in the work force.

People who drink should help pay for this unnecessary expense to society.

Thank you.
Carl Nykamp

THE LEADER IN PRESSURE WASHERS

1101E Haddon View Apts.
Westmont, NJ 08108
August 11, 1987

Repr. Dan Rostenkowski
Chairman, House Ways and Means Committee
House Office Building
Washington, DC 20515

Subject: Please Double the Liquor Taxes

Dear Mr. Rostenkowski:

Alcohol, the product destroying so many lives each year, should provide more revenue for our deficit national budget. The Center for Science in the Public Interest says, "Doubling liquor taxes and then equalizing the rate of tax on alcohol in liquor, beer and wine as proposed by the National Alcohol Tax Coalition would provide approximately $12 billion in additional federal revenues, decrease alcohol consumption by about 14 percent, and reduce annual economic costs of alcohol by up to $16 billion."

Thank you for your time and consideration to this proposal.

Sincerely,

Mrs. Helen E. MacDonald

Mr. Stanley N. MacDonald

MAROA UNITED METHODIST CHURCH
P.O. Box 128
MAROA, ILLINOIS 61756
Church — Corner Washington & Walnut Sts.
Phone (217) 794-2209
Parsonage — Phone (217) 794-5550

July 10, 1987

Rep. Dan Rostenkowski
Chairman, House Ways and Means
House of Representatives
Washington, DC 20515

Dear Mr. Rostenkowski:

It is my understanding the House Ways and Means Committee is considering the wisdom of raising Federal Excise Taxes on beverage alcohol as a means of meeting the proposed budget of a trillion dollars. I VERY MUCH SUPPORT THIS INCREASE.

Alcoholism is one of the greatest problems of our society, causing problems in families, the workplace, and also the vast costs of medical care to those who drink as well as those they injure. It would seem only fair for the taxes on alcohol to be large enough to cover all the costs of alcoholism to society (including the extra costs of medical care to the aged in Medicare).

While only a small start toward this goal, the proposed $12 billion increase would pay the combined annual costs of the National Institute on Alcohol Abuse and Alcoholism, the Administration on Aging, the juvenile justice and child abuse state grant programs, and the federal food stamp program.

The total costs of alcohol to our society are staggering. We should never cut those programs that help people at the expense of those programs which hurt society. Please vote to make those responsible for so many of society's problems to be responsible for the expenses of correcting those problems.

Sincerely yours,

John R. Crede

John R. Crede
Pastor

MATANZAS
CREEK
WINERY

June 3, 1987

Chairman Dan Rostenkowski
Committee on Ways and Means
1102 Longwoth H.O.B.
Washington, DC 20515

Dear Mr. Chairman:

Regarding the "Equivalency Tax" proposal for wine:

At a time when the wine industry is recovering from destruction by Prohibition, dealing with renewed Prohibitionist assaults, being attacked by the hard-liquor controlled distribtutiton system, fighting discrimminatory alcoholic beverage laws in fifty states, and squeezed by imports, your Committee is now seeking to impose more burden on us.

If your are interested in seeing our beseiged industry and winegrape farmers lose markets and ultimately their businesses, increasing the federal wine excise tax is a sure way of succeeding. If you're interested in treating the product of American farmers as "booze" by tying it more closely to the irrelevant factor of equivalent alcohol, then this tax proposal is on the right track.

On the other hand, if you're interested in supporting agriculture and the return of the winegrape industry to its pre-Prohibition status as a important national asset, it's essential to defeat this proposed revenue source.

We urge you to take into consideration that we are an infant industry with large investment, high risks and needing time to grow. We are heavily promoting market development which this proposal will undermine.

Agriculture continues to be in deep and serious trouble across the land. The winegrape industry is one of the few agriculturally based industries that are growing and where agricultural success is just beginning to happen. We deserve a chance to succeed and regain our place in history.

We urge you to oppose this tax increase on American agriculture.

Sincerely,

William B. MacIver

6097 bennett valley road □ santa rosa, california 95404 □ (707) 528-6464

MATANZAS
CREEK
WINERY

August 28, 1987

Dan Rostenkowski, Chairman
House Committee Ways and Means
Congress of the United States
1102 Longworth HOB
Washington, D.C. 20515

Dear Senator Rostenkowski:

I bring to your attention the enclosed article in Wines and Vines, August 1987, by economic analyst George Scofield, regarding the proposed federal excise tax increase on wine. As Mr. Schofield's analysis indicates, this is the wrong time to add another economic burden to this segment of agriculture.

I am also enclosing my comments on this tax proposal I made last June to you which are still pertinent and relevent to the issue.

American agriculture is in serious trouble. Please work with us to prevent another financial blow to farmers.

Sincerely,

William B. MacIver

Enclosures

6097 bennett valley road □ santa rosa, california 95404 □ (707) 528-6464

How a tax hike would hurt wines

GEORGE M. SCHOFIELD

Don't tax me! Don't tax thee! Tax the man behind the tree!

One doesn't have to listen very long to the rhetoric behind the reduction of the federal deficit to realize that a real political dilemma is involved. The spending side of the equation is seemingly inflexible. Social programs in most cases can't be cut because essentially the money already has been spent. The administration also is committed intractably to a program of military spending. The revenue side is equally difficult. President Reagan has vowed to veto any tax legislation that compromises the income tax cuts and reforms of 1982 and 1986.

And so the search proceeds for the man behind the tree. Neoprohibitionists and other groups who are either opposed to, or merely disinterested in, wine, are actively and gladly pointing to the wine industry. The disarray and publicity surrounding the equivalency issue has certainly helped these advocates of excise tax increases to herald their cause.

The appealing thrust of the proponents is that higher excise tax will raise billions of dollars of new tax revenue and at the same time cure society of many ills. Michael F. Jacobsen, of the National Alcohol Coalition in testimony on July 7, 1987, before the Committee on Ways and Means on Revenue Increase Options, recommended to members of the U.S. House of Representatives that, "by equalizing the excise tax rates on wine and beer to the "hard liquor" rate, $4.7 billion of new tax annual revenue could be raised." Jacobsen also claimed a further doubling of the equated excise tax rate would net almost $12 billion per year.

Many major flaws exist in the logic of the wine excise tax proponents. Sweeping generalizations involving wine abound. The claim of additional tax revenue appears to be an arithmetic exercise with no relationship to the economics of supply and demand. Certainly, little thought is devoted to the agricultural nature of wine and particularly to the economic impact back on the farm. The economic reality is that any wine excise tax will not generate a significant amount of net tax dollars, particularly considering the adverse effects on farmers' income and the related secondary and tertiary economic impact.

The total of all wine excise taxes including imports produced an estimated total of $270 million in federal tax revenue in 1986. Over $150 million of the revenue (55%) was generated by the relatively high tax on the low volume sparkling wine category. In 1986, the U.S. table wine market generated an estimated $83 million in tax revenue. Because of the low base relative to a $200 billion deficit and because of the current dire economic conditions in the table wine and grape industries, the table wine excise tax is in reality a poor revenue option at this point in time.

Strongly supporting the contention that an increase in wine excise tax may be counterproductive is an April 1984 U.S. Department of Agriculture Report. In a letter to Senator Pete Wilson, Assistant Secretary Robert L. Thompson indicates, "a 10% increase in the price of wine would reduce wine demand 5-6%. Assuming such a reduction was spread evenly between domestic (sic), and imported wines, U.S.

EXHIBIT 1
ESTIMATED FEDERAL WINE EXCISE TAX

		CURRENT	
	Gallons (Millions)	Tax Rate $/Gallon	Tax ($ Million)
Table Wines	351	$ .17	$ 60
Wine Coolers	120	.17	20
Other Spec. Nat.	16	.17	3
Subtotal Under 14%	487	$ .17	$ 83
Dessert	35	$ .67	$ 24
Vermouth	6	.67	4
Other Spec. Nat.	14	.67	9
Subtotal Over 14%	55	$ .67	$ 37
Sparkling	44	$3.40	$150
TOTAL	586	$ .46	$270

EXHIBIT 2
1986 U.S. WINE MARKET

	Gallons (Millions)	% of Total	% Growth Over 1985	Cumul. % Growth Over 1981
Table Wines	351	60%	(7%)	(9%)
Wine Coolers	120	20%	+37%	*
Other Spec. Nat.	16	3%	+7%	(33%)
Subtotal Under 14%	487	83%	+1%	+19%
Dessert	35	6%	+2%	(17%)
Vermouth	6	1%	(7%)	(20%)
Other Spec. Nat.	14	2%	16%	+33%
Subtotal Over 14%	55	9%	4%	(9%)
Sparkling	44	8%	(4%)	+29%
TOTAL	586	100%	+1%	+16%

*No significant amount of wine coolers sold in 1981.

wineries would lose up to 24 million gallons of demand and vineyards could lose a market of 150,000 tons of grapes." Secretary Thompson's conclusion is that direct winery and vineyard losses when combined with associated losses elsewhere in the economy would run at a ratio of almost $2 of losses for each $1 of added excise tax revenue.

Certainly the scenario described by Assistant Secretary Thompson is depressing. However, another prospect is even equally alarming to growers. Considering the weak demand for traditional table wines and the surplus of generic and raisin variety grapes, significant consumer price resistance ought to be expected for any cost increase, including higher wine excise tax. Obviously at some point, higher taxes would have to be passed on to consumers. However, when chronic surpluses of agricultural products exist, the tendency is for any pressure to result in lower raw material prices. The economic scenario is generally for prices to be driven down to the level of marginal production, thereby causing an exit of some vineyards. Only when supply is brought into balance with demand can much price relief be expected.

The wine industry experience since 1981 illustrates this tendency. Excluding the dynamic "Cooler" category, which accounts for 20% of the total wines sold in the U.S. (but which is only 50% wine), the U.S. market for traditional table wines has declined 9% from 1981 to 1986.

During the time period from January 1982 thru May 1987, the overall Consumer Price Index rose 20%. During this same period the CPI for all wines rose 7%. Hence, over almost the last 5⅓ years, it has not been possible to raise consumer wine prices proportionally to inflation. Similarly, the current weakness of imports in the face of strong foreign currencies is another example of consumer price resistance.

White generic table wines represent the backbone of the wine industry and account for about 40% of all wines sold in the U.S. This important category has displayed price deterioration over the past several years. The new BLS Producer Price Index for white generic table wines declined 6% from the point of its inception in December 1983 to May 1987. Hence, there is strong evidence against non-premium wineries having the ability to raise prices significantly.

CANNON HOUSE OFFICE BUILDING
ROOM 131
WASHINGTON, DC 20515

ADMINISTRATIVE ASSISTANT
SUZANNE STOLL

DANIEL A. MICA
14TH DISTRICT, FLORIDA

FOREIGN AFFAIRS

VETERANS' AFFAIRS

SELECT COMMITTEE ON
AGING

Congress of the United States
House of Representatives
Washington, DC 20515

July 17, 1987

[illegible] 1987

Honorable Dan Rostenkowski
1102 Longworth HOB
Washington, D.C. 20515

Dear Mr. Rostenkowski:

I would like to take a moment of your time to express my concern regarding a possible option to raise revenue which will be brought before the Ways and Means Committee when mark-up begins at the end of this week.

It has been brought to my attention that one of the possible targets for reconciling the deficit goal in 1988 is the repeal of the reduced tax rate on alcohol content in distilled spirits attributable to wine or certain flavors.

As I understand the situation, a number of different tax approaches are practical, but the repeal of this reduced tax could be catastrophic for producers of wines which are used in distilled liquors. In addition, orange and other citrus producers who supply the wine industry would be injured, causing economic hardship for many citrus growers.

Deficit reduction must be accomplished by means which spread the burden evenly among the different facets of the economy. If industries must suffer, let us not make one particular industry accept more burden than the others. To repeal the reduced tax would create an unjust amount of harm to the wine industry, as well as force many producers out of work.

Thank you for your consideration.

With kind regards,

[redacted]

Sincerely,

DANIEL A. MICA, M.C.

DM:nj

PLEASE REPLY
☐ CANNON HOUSE OFFICE BUILDING
ROOM 131
WASHINGTON, DC 20515

☐ 639 EAST OCEAN AVENUE
SUITE 303
BOYNTON BEACH, FL 33435

THIS STATIONERY PRINTED ON PAPER MADE WITH RECYCLED FIBERS

WRITTEN STATEMENT OF

MILLER BREWING COMPANY

TO THE

COMMITTEE ON WAYS AND MEANS

U.S. HOUSE OF REPRESENTATIVES

WASHINGTON, D.C.

Presented by:

Alan G. Easton
Vice President of Corporate Affairs
Miller Brewing Company
Milwaukee, Wisconsin
July 7, 1987

Mr. Chairman and distinguished Members of the Committee on Ways and Means, Miller Brewing Company appreciates this opportunity to present a written statement on behalf of our more than 10,000 employees and America's 80 million beer drinkers.

The proud traditions of the domestic brewing industry date back to Colonial times. Our company was founded in Milwaukee in 1855 by German immigrant Frederic Miller. Today, we have major production facilities in six states. Our products are sold in all 50 states, the District of Columbia, Puerto Rico and the U.S. Virgin Islands through a network of 740 independent distributors.

Last year, Miller Brewing Company had a total economic impact (including salaries, wages, taxes, material purchases, marketing costs and capital expenditures) of more than $3 billion. The brewing industry as a whole -- production, wholesaling and retailing -- creates some 2 million U.S. jobs and generates $114 billion in economic activity, or close to three percent of the Gross National Product. The domestic brewing industry purchases more than $900 million in U.S.- grown farm products, supporting almost 19,000 farm jobs. Through direct purchases of bottles, cans, cartons, labels and a myriad of other goods and services, brewers have a huge impact in the manufacturing, transportation and service sectors of the U.S. economy. The dollars generated by the brewing industry are spent and re-spent throughout the economy by businesses and employees receiving incomes from our industry.

But, our's is an intensely competitive industry with slim profit margins. Sales in the 1980's have been mostly flat to down for a number of reasons including the aging of our population. Consolidation within the industry has caused the closing of 30 American breweries with the loss of 4,000 jobs since 1977.

Additionally, we face foreign imports that can price-compete with our products because of small import duties, yet we are denied export access to many of the countries that regularly flood the import beer section of your store and mine.

U.S. brewers pride themselves on being good employers, good corporate citizens and socially responsible. In our Milwaukee hometown, for example, we support a wide range of activities such as the ballet, zoo, ethnic festivals and many, many charities. Through the medium of radio and TV, brewer advertising dollars bring baseball, football and other sports and entertainment into America's living rooms. We want Americans to enjoy our products in good health and actively support numerous education programs to help curb alcohol abuse.

America's brewers and U.S. beer drinkers already pay staggering taxes. Brewers and beer drinkers pay the usual federal, state and local taxes on their incomes and property, in addition to sales taxes, gasoline taxes, school taxes and the like. But, because the product is beer, it is subject to special tax treatment by all 50 states and the federal government. At the present federal excise tax rate of $9.00 per barrel, the federal government makes more than twice as much money per barrel of beer as the brewer does in profit. In 1985, (latest figures available) the states collected $1.37 billion in beer excise taxes. While some say beer is "overdue" for a tax increase, as if the date a tax was last raised is some criteria, they ignore the fact that since 1951, state and local revenues from beer have increased 564 percent. Beer is now taxed at a rate that is three times higher than most any other consumer product, with the tax amounting to more than the combined cost of labor and ingredients to make the beer.

Historically, beer drinkers have been taxed to help pay for war debts. The first tax on beer was earmarked for the Civil War effort, then raised for each succeeding war with the last taking place in 1951 to finance the Korean War. Excise taxes, such as the beer tax, are not efficient forms of taxation. With the tax imposed at the producer level, consumers wind up paying several times what the government collects because of mark-ups at the wholesaler and retailer levels plus any added sales tax. Excise taxes also violate the principles of fairness as promised in the Tax Reform Act of 1986 because they single-out a particular product and its consumers, and are hidden from the consumer in the price of the product.

Here in Milwaukee, a beer with friends in a local tavern after work, or after bowling, is an important part of our community social culture and traditional heritage. At a Brewer's baseball game, a cold beer adds to the enjoyment of the game.

While some in government and elsewhere label beer taxes as "sin taxes," to punish America's working men and women with increased taxes on certain items such as their beer is "sinful" in itself. Others have testified that Congress should use taxation to legislate good health by "punishing" a host of products they deem to be unhealthy. Such proposals by these "social engineers" would set a dangerous precedent and should not be considered as part of any tax policy. Higher beer taxes would unjustly penalize most of the 80 million beer drinkers who cost society nothing because they drink moderately. More than 100 studies have shown that moderate drinking benefits health.

America's beer drinkers are mostly low to middle-income, working men and women with family incomes below $30,000. The 99th Congress promised tax fairness through the Tax Reform Act of 1986. America's working men and women were promised a fair measure of tax relief while loopholes that benefited mostly the rich were closed or tightened. Now, however, some are proposing increased excise taxes that will most heavily impact on working, middle and lower income people -- taking back all or more of their tax reform benefits and reducing their spending power.

Mr. Chairman and Members of the Committee, I ask that you carefully consider the possible negative economics associated with increased excise taxes. America's working men and women don't deserve to have the taxes increased on the beer they drink, the gasoline they need to get to and from work, their telephone or on the airplane tickets they saved for and bought to take the kids to Disneyland.

As increased beer taxes cause increased prices, simple economics tell us that sales will drop. As a result, state excise tax revenues will fall, workers will be displaced onto the unemployment rolls and the beer industry's impact throughout the economy will decrease. And, yet another healthy domestic industry may be knocked onto the ropes.

At Miller Brewing Company, every employee is treated fairly. Our business is successful because of efficiency and cost control. Surely government can increase efficiency and control costs too without having to ask working people to shoulder more and more taxes. America's brewers and 80 million beer drinkers are presently paying their fair share of the tax burden -- and more.

Thank you.

-gpw-

COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
OPTIONS TO RAISE REVENUES

The New York State Division of Alcoholism and Alcohol Abuse is the state agency responsible for, among other things, the prevention and treatment of alcoholism and alcohol abuse. We recommend that federal taxes and fees on alcoholic beverages be substantially increased and that such increase be specifically allocated for the prevention and treatment of alcoholism and alcohol abuse.

Nationally, alcoholism accounts for between 200,000 and 300,000 deaths or injuries each year. One in every ten deaths is alcohol related and on any given day 33% of the adult patients in U.S. hospitals are likely to have problems related to alcohol. It is estimated that 20% of the national expenditure for hospital care and 12% of the total national health expenditure on behalf of adults derive directly from alcohol abuse. Alcoholic persons have mortality rates approximately 250% above those expected for nonalcoholics. Alcoholic persons have two to three times as many illnesses as nonalcoholics and two to three times more expenses for health care. Alcohol consumption is a major cause of industrial, home and recreational accidents. It is involved in 70% of all deaths from falls, 83% of deaths from fire and 50% of drownings. Alcohol also plays a significant role in suicide. A minimum of 30% of those who take their own lives had been drinking at the time. Fifty percent of all arrests in the U.S. are alcohol related. Alcohol is also involved in 80% of all homicides, 70% of serious assaults, 50% of forcible rapes, 72% of robberies and 65% of child abuse cases.

The complications or risks associated with alcohol use during pregnancy are well documented. Fetal alcohol syndrome (FAS) prevalence rates vary from 23% to 29% per 1,000 in women who have been identified as alcohol abusers. A study by the Division of Alcoholism and Alcohol Abuse Research Institute on Alcoholism estimated a lifetime cost of $155 million for those born in a given year with FAS and alcohol-related birth defects in New York State alone (Russell, 1980).

Alcoholism affects more people than just the alcoholic. It adversely affects not only the alcoholic's spouse but also the children of the alcoholic. It is estimated that there are seven million children under the age of twenty with one or both alcoholic parents; 500,000 of them living in New York State. Some studies have determined that the rate of separation and divorce among alcoholic persons and their spouses is seven times that of the general population.

Approximately 40% of all problems brought to family court are directly linked to alcohol abuse. The children in alcoholic families are approximately four times more likely to develop alcoholism themselves, and may also marry into another family with alcoholism thereby perpetrating the cycle.

Alcohol's contribution to highway accidents and fatalities is well documented. Drinking drivers involved in crashes cost New Yorkers nearly a billion dollars a year in health care, property damage and lost productivity. These costs are borne by all New Yorkers in the form of higher taxes and insurance rates.

Added to the societal costs of drinking drivers is the $5 billion annual cost to the New York economy of alcohol impaired employees who suffer injuries on the job or whose employment or productivity is reduced by intoxication and the health consequences of continued heavy drinking.

Overall it is estimated that alcohol problems cost New Yorkers over $8 billion a year and over $100 billion nationally. These financial consequences do not address the human suffering due to accidential deaths and injuries and the longterm consequences of alcohol use such as cirrhosis, pancreatitis and various forms of cancer.

The demand being placed on New York's alcoholism service agencies is enormous, and is escalating rapidly. New laws, such as the STOP-DWI program, are putting thousands of new clients into a system that is already overloaded. There are estimated waiting lists from four to six weeks for entrance into treatment programs in most counties that have such programs. Meanwhile, federal revenues for alcoholism programs are decreasing.

Although alcoholism is widely recognized as the number one public health problem in the country, it does not fare well in terms of public tax dollar support compared to drug abuse or mental health programs. Alcoholism and alcohol abuse programs have been consistently underfunded.

In spite of all the evidence of the enormous costs to society of alcoholism and alcohol abuse there remains a lack of understanding by not only the public but by its governmental representatives of its pervasiveness. Funding for alcoholism services has remained fairly constant and has not even kept pace with inflationary growth. Government has failed to recognize that the tremendous costs to society of alcoholism and alcohol abuse can be reduced by an appropriate investment in an alcohol services delivery system.

Alcohol consumption in the United States since World War II has been characterized by a steady increase. The present rate of consumption is 2.8 gallons of pure alcohol per person per year, or about two drinks a day (Moore and Gerstein, 1981).

During this same historical period, the real price of alcoholic beverages in the U.S. has fallen dramatically. After correction for inflation, the price of liquor declined 48% between 1960 and 1980, with beer and wine showing a 27% and 19% decrease respectively (Moore and Gerstein, 1981). Part of the reason for this decline has been that State and Federal taxes on alcoholic beverages have not kept pace with the rising cost of living.

A variety of scientific studies have established that the consumption of alcoholic beverages will increase when the price declines, and decline when the price increases.

The most famous example occurred in Denmark in 1918, (Medicine in the Public Interest, 1976). The price of a liter of popular Danish liquor was increased from 0.9 to 11 Danish Crowns. This caused an 80% decrease in alcohol sales, with a correspondingly large decline in the death rate from cirrhosis.

Ornstein (1980) reviewed the studies to that date, and concluded that consumption is sensitive to price changes. The studies indicated an increase in 10% of the price of liquor will result in a decline in consumption of between 10% and 20%. He concluded that there would be lesser, but still noticeable, effects of increase in the price of beer and wine. These conclusions belie the common belief that there must be huge increases in price to have a noticeable effect on alcohol sales.

Other studies by Johnson and Oksanen (1977), Ornstein and Hanssens (1981) and Cook and Tauchen (1982) provide similar evidence of price elasticity.

Johnson and Oksanen used data from 10 Canadian Provinces for the period 1956 to 1970. As well as examining the price and amount of sales of alcoholic beverages, their model also took into account ethnic composition, age profile, and other social and economic factors. They found that a 10% increase in the price of liquor will lead to a 17% decrease in consumption.

Ornstein and Hanssens (1981) used data from 5 years for the 50 U.S. states and reached a similar conclusion for the different types of alcoholic beverages. This study considered the effects of alcohol prices in bordering states.

In the most ambitious effort to date, Cook (1981) and Cook and Tauchen (1981) used data from 30 states for the period 1962 - 1977, concentrating on 39 instances in which a state raised its tax. They demonstrated conclusively that price increases cause consumption declines and were not merely correlated with them. They found, for example, that a one dollar per gallon increase in liquor taxes decreased consumption by 7.2%.

The studies mentioned above, and many others, establish that moderate increases in the price of alcoholic beverages will cause a noticeable decline in consumption. This decline is traced to reduced consumption by heavy and moderate drinkers, as demonstrated by the established link between per capita alcohol consumption and death rates from cirrhosis (Bush, Steinberg and Brook, 1984).

Another criteria is the percent of disposable income being spent on alcohol. A light drinker can maintain his consumption in the face of substantial increase in price if he so desires, without noticing the pinch. This is not so for an individual who is devoting a substantial percentage of his disposable income to alcohol.

A 1981 study by Cook estimated that 5% of the 15 and older population are responsible for 50% of the alcoholic beverage consumption or that one-third of the population is responsible for 95% of the alcohol consumption. In light of these estimates he concludes that it is unlikely that the numerous findings indicating per capita consumption decreases in response to price increases could be due entirely to light and moderate drinkers. He also cites the large price increases brought about by prohibition as a factor in the corresponding reductions in cirrhosis mortality death rates.

Therefore, changes in alcohol taxation policies which increase the consumer price of alcoholic beverages can be expected to reduce consumption thus reducing the medical, health and highway safety consequences of alcohol abuse.

Dedication

The concept of devoting revenues raised from special sources to be used for specific projects, although new to alcoholism, is not new in tax administration. Federal laws have established numerous special taxes dedicated for special purposes, such as highway construction, forest preservation, hazardous waste and several other purposes.

A 1983 survey done by the National Association of State Alcoholism and Drug Abuse Directors indicates that 18 states have laws dedicating alcohol beverage taxes to funding of alcoholism programs. In South Carolina a poll by Metromark Market Research done for the South Carolina Commission on Alcohol and Drug Abuse revealed that 84% of the population favored increasing taxes on alcoholic beverages in order to provide additional funding for alcohol prevention and treatment programs.

Use of the dedicated tax is most important to the alcoholism field because of the rapidly declining federal revenues for human services and because many alcoholism programs, such as alcohol crisis centers, are not able to generate revenue by either self pay or third party reimbursement.

A special tax dedicated for alcoholism services would stabilize alcoholism programs. Traditionally, as evidenced by federal activities, as funding constraints increase programs dependent upon public funding are the first to be cut back.

A dedicated alcohol tax can ensure continuation of existing alcohol programs and substantially improve the services for youth, alcoholism prevention, and related research.

The concept of dedicating a portion of alcohol tax revenues to alcohol services is achieving wide recognition because such a revenue producing measure makes good sense:

- An additional tax on alcoholic beverages does not affect that portion of disposable income that goes into the essentials of food, clothing, and shelter.
- The burden falls on citizens in proportion to their alcohol purchasing since five to ten percent of the adult population consumes fifty percent of the alcoholic beverages purchased.

New York, like other states, is already operating under extraordinary financial pressures. In these circumstances, an increase in federal alcohol taxes is both a prudent fiscal step, and a probable precondition to developing an adequate system of services for alcoholic persons and alcohol abusers. Until a significant change is possible in base funding for the alcoholism programs, it is unlikely that significant progress will be made beyond the current level.

The New York State Division of Alcoholism and Alcohol Abuse (DAAA) has had to rely heavily on federal funds to continue existing programs. This apparent shift in funding of the alcoholism service base has been identified in the Division's last three budget requests as a very high risk in view of the severe restrictions being imposed on the federal level over the last two administrations. These restrictions continue to be imposed and are increasing annually.

Under current provisions of the Federal Block Grant, New York State must exercise discretion over 30% of the federal funds available for alcoholism and drug abuse. Presently, all of these discretionary funds are allocated to the Division of Substance Abuse Services (DSAS). At the present spending levels, both DAAA and DSAS will have budgeted obligations requiring competition for these discretionary funds in the 1987-88 State Budget. If recent progress in coordinating joint programming by DAAA and DSAS is to continue, action by the federal government to preclude the necessity of competition between the constituencies for these programs is crucial.

Viewed as a whole, the foregoing leads to the conclusion that there is an absolute need to seek optional sources of funds. The fairest and most sensible is an increase in the alcohol tax. Because the small amount of the population which consumes the disproportionately greatest percentage of alcohol is most likely to be involved in alcohol-related problems, it is logical that a portion of the price they pay for alcohol be available for alcoholism services which they are most likely to require.

The Division recommends the establishment of a special alcoholism fund into which the increase in alcohol taxes would be deposited and made available for alcoholism services. Traditionally, the lack of understanding and remaining pervasive prejudices have kept discretionary spending on alcoholism well below minimum needed levels. Guaranteeing a minimum level of support free from the need to compete with other interests would assure that alcoholism prevention and treatment priorities and obligations could be met in each community.

Submitted by:

John R. Harder
Counsel
New York State Division of
Alcoholism and Alcohol Abuse
194 Washington Avenue
Albany, New York 12210
(518) 473-4748

NCDL INC.
North Carolina Distillers League, Inc.
P.O. BOX 25367 • RALEIGH, NORTH CAROLINA 27611 • 919-833-6633

August 3, 1987

Mr. Dan Rostenbowski, Chairman
House Ways and Means Committee
2111 Rayburn HOB
Washington, D C 20510

Dear Sir:

The Officers and Members of the North Carolina Distillers League, Inc., attending their Summer Conference in Asheville, N.C. recently, learned Congress is considering an increase in tax on liquor.

The Members of the League join me to oppose any increase of any kind at the present time. Our sales are down, and to add a tax would cut them even more. Any consideration in our favor, in this matter, would be appreciated. With best regards I am

Yours Truly,

Scott

Scott Kelly
Secretary-Treasurer

SK/jn

3425 D STREET,
LINCOLN, NEBRASKA
JULY 29, I987

CHAIRMAN DAN ROSTENKOWSKI,
III4 LONGWORTH HOUSE OFFICE BUILDING
WASHINGTON. D.C.

HONORABLE CONGRESSMAN ROSTENKOWSKI:

I UNDERSTAND THAT THE COMMITTEE ON WAYS AND MEANS IS CONSIDERING AN INCREASE IN TAXES ON BEER, WINE AND LIQUOR. I BELIEVE THESE TAXES HAVE NOT BEEN INCREASED SINCE I95I SO A TAX INCREASE IS LONG OVER-DUE. THE LIQUOR INDUSTRY DOES NOT BEGIN TO PAY ITS WAY ON THE I20 BILLION DOLLAR DEBT IT INFLICTS ON OUR CITIZENS. I DO NOT KNOW WHAT THE NATIONAL TAX AMOUNTS TO BUT IN NEBRASKA LIQUOR COSTS OUR ECONOMY I.3 BILLION DOLLARS AND WE RECEIVE ONLY I3.I MILLION DOLLARS IN TAXES.

IF A TX INCREASE WOULD DISCOURAGE THE DRINKING THAT IS CAUSING THOUSANDS OF HIGHWAY ACCIDENTS, CAUSING MOST OF THE CHILD ABUSE, THE MANY ILLNESSES THAT INCREASE INSURANCE COSTS, THE LOSS IN PRODUCTIVITY, ALCOHOL INVOLVED CRIME AND THE MANY FIRES DUE TO DRUNKENESS IT WOULD BE WORTH THE INCREASE MANY TIMES OVER.

PLEASE INCREASE THE TAXES SO THAT THE LIQUOR INDUSTRY WOULD BE PAYING EVEN A FRACTION OF THE COSTS THEY INFLICT ON SOCIETY. SINCE I STARTED THIS LETTER I HAVE FOUND A FIGURE OF $I2, 630,000,000 THAT THE INDUSTRY PAYS IN REVENUE BOTH STATE, FEDERAL AND LOCAL. THAT IS ONLY A TENTH OF THE COST OF ALCOHOLISM NATIONALLY. THEY ALSO TAKE OUT $66,354,000,000 OUT OF THE PAY CHECKS OF THE AMERICAN PEOPLE AT THE CASH REGISTER. IT IS NOT SURPRISING THAT THERE ARE SO MANY ALCOHOLICS ON WELFARE.

SINCERELY,
Helen L. Patzel

1412

EDUARDO M. AND ANNE N. SARDINA
4995 S.W. 78TH STREET
MIAMI
FLORIDA 33143

305/663-1409

August 12, 1987

Representative Dan Rostenkowski
House Ways and Means Committee
2111 Rayburn HOB
Washington, D.C. 20515

Dear Representative Rostenkowski:

I wish to register my opposition to any contemplated increase in Excise Tax on distilled spirits and wines.

The liquor industry alreads bears a disproportionately high federal, state, and local tax burden, and any additional taxes would only serve to create further hardships at all levels.

Sincerely,

E. Sardina

Eduardo M. Sardina

July 17, 1987

The Honorable Dan Rostenkowski
House Ways and Means Committee
U. S. House Of Representatives
Washington, D. C. 20515

Dear Congressman Rostenkowski,

As an employee of Heublein Inc., a producer and marketer of Distilled Spirits it seriously concerns me that once again Congress is considering raising excise taxes on liquor. I continue to solicit your support is opposing such a tax hike.

In 1985 Congress approved a 19% tax increase on Spirits in an effort to help reduce the deficit. In reality, the tax increase has fallen $670,000,000 short of the original joint tax committee estimates on revenues to be generated from the increase at that time. In addition it is estimated that State revenue collections may be off as much a $100,000,000 as a result of sales drops resulting from the October 1985 FET tax increase.

Since the October 1985 19% Federal Excise Tax increase in Spirits, sales are off 7% and Spirit imports are down 15%. Over the last five years per capita liquor sales have declined at a rate of approximately 2.6% annually.

With declining sales there is a further consolidation in the industry with fewer Distilled Spirit's bottlers and producers. In 1986 there were 8.7% or 16 fewer Distilled Spirit's bottlers and producers than in 1978. The net result - loss of jobs to many individuals.

As you can well see, our industry is already in trouble and employment continues to shrink every year. There is a limit to the amount of taxation our industry can bear therefore, we request that you please vote NO on any increase of the liquor Federal Excise Tax.

Sincerely,

Vincent P. Scacchitti
4 Acorn Dr.
North, Granby, CT 06060

(202) 638-2626
TELEX 440650
FAX MAIL 2026384231

SALES AND CATERING

The Sheraton Carlton
16th and K Streets, N.W., Washington, D.C. 20006

July 14, 1987

The Honorable Dan Rostenkowski
House Ways and Means Committee
U.S. House of Representatives
Washington, DC 20515

Dear Congressman Rostenkowski:

It has recently come to my attention that you and your distinguished colleagues are considering to pass legislation which would increase the excise tax on alcoholic beverages. Any such increase would negatively impact food and beverage sales in the hotel industry.

I am a Director of Food & Beverage at the Sheraton Carlton Hotel here in Washington. Every additional tax legislated on entertainment and alcohol dramatically effects our overall profitability.

In our industry, we service our customers. We are not asking Congress for any special treatment, we believe the hospitality industry contributes its fair share to the federal government. However, when the federal tax on beer for example is more per barrel than the brewer makes in profit, then I believe the tax is unfairly levied.

I urge you not to support any legislation increasing the excise tax on alcoholic beverages. Show us, the taxpayer, that the 100th Congress will respond fairly to tax reforms and revenue generating laws by not passing "hidden" taxes.

Sincerely,

Ed W.M. Jongen
Director of Food and Beverage

EWMJ/dcc

**Sheraton
Inner Harbor Hotel
Baltimore**
The hospitality people of
ITT

300 SOUTH CHARLES STREET
BALTIMORE MARYLAND 21201
TELEPHONE (301) 962-8300

July 8, 1987

Congressman Dan Rostenkowski
House Ways & Means Committee
Room 1102
Longworth Office Building
Washington, DC 20515

Dear Congressman Rostenkowski:

As a member of the hospitality industry, I am very concerned about the proposed increase of the federal excise tax on beer that is being discussed in the 100th Congress. As managers of two very successful lounge operations, we feel that this increased excise tax will hurt not only our operation, but our customers as well.

Excise taxes hurt low to middle-income consumers as they are "hidden taxes" buried in the cost of products and services. Beer drinkers, for instance, already pay about three times as much tax on their beer as on almost any other consumer product. The tax on beer is now more than the cost of the ingredients and labor to make it! Beer is the beverage of choice for working men and women. An increase in the tax on beer would single out this already beleagured group of taxpayers.

An increased excise tax on beer would damage the domestic beer industry, an important contributor to the American economy. If sales were to decrease as a result of an increased excise tax, many of the 150,000 people now employed in the beer industry would be in jeopardy of losing their jobs. At present tax rates, the federal government makes more money per barrel of beer than do the brewers who make the beer.

I urge you, on behalf of the hospitality industry, the beer industry and the people whom both of the these industries service to oppose this increased excise tax. In all fairness, Congress should be honest with the taxpayers and not ask them to pay for a "hidden tax" which would be contrary to the Tax Reform Act of 1986 in which these very consumers promised a tax reduction.

Thank you for your consideration of this matter.

Sincerely,

Gary Southern
Beverage Manager

GS/sk

THE SHERATON INNER HARBOR HOTEL IS OWNED BY THE BALTIMORE HARBOR CENTER LIMITED PARTNERSHIP
AND MANAGED BY THE SHERATON OPERATING CORPORATION

Edna Suits
610 Coronada Circle Lot 103
Kokomo,In. 46901

Rep. Dan Rostenkowski
Chairman, House and ways and means
Committee
House Office Bld.
Washington, D.C.

Dear Sir:

As a member of the Womans Christain Temperance union I'm interested in Congress serious intitive to raise taxes on alcohol. Current tax is only 16¢ for a six pack raising it to 65¢ and from 3¢ to 55¢ on a quart of wine. I urgently request the this becomes a bill, and that it reaches the full congress for a vote. If taxes had been raiesed on Alcohoal as other products has since, it was put back on the market, our Federal Treasure would be over 5 billion dollars. which could help our debts.

Thanking you
Edna Suits
North Kokomo WCTU.

COMMENTS OF

HONORABLE ALEXANDER A. FARRELLY
GOVERNOR OF
THE U.S. VIRGIN ISLANDS

Mr. Chairman and distinguished Members of the House Ways and Means Committee, I am pleased to have this opportunity to comment on certain of the proposed revenue increase options that could have a significant impact on the Virgin Islands budget and essential capital projects in the Territory. In particular, the Virgin Islands is concerned that, unless restrictions imposed in 1984 on the cover-over mechanism of Internal Revenue Code Section 7652 are removed or otherwise modified, _any_ increase in the federal excise tax on distilled spirits would further _decrease_ V.I. Government revenues and further strain the historic covenants on which the Federal-Territorial relationship is based.

Through the cover-over law -- under which federal excise taxes on Virgin Islands rum are returned to the Territorial Government -- the V.I. rum industry in recent years has generated approximately 15 percent of the Territory's total budget revenues. However, since 1983, the Virgin Islands has experienced a 20 percent decrease in rum excise tax revenues. This decrease, which has already had an adverse impact on the Territory's ability to finance vital infrastructure and other capital projects, is directly attributable to the 1984 Tax Act which, by increasing the excise tax on distilled spirits, cut demand for V.I. rum while capping the amount of excise taxes covered over to the Islands treasury.

The Virgin Islands Government submits that the 1984 cap on the cover over of rum excise taxes under Code Section 7652 is inequitable and inconsistent with the legislative purposes of the cover-over statute, as well as with established Federal-Territorial principles. Any increase in the federal excise tax on distilled spirits -- without elimination, or significant modification, of the cover-over restrictions -- would only exacerbate these inequities, magnify the inconsistencies and, at the bottom line, further decrease critically needed V.I. revenues. Accordingly, I respectfully urge that these problems be addressed as part of any effort to increase excise taxes on distilled spirits.

PRE-1984 TAX ACT

Prior to the 1984 Tax Act, _all_ internal revenue taxes imposed on products manufactured in the Virgin Islands were covered over to the treasury of the Virgin Islands pursuant to Section 28(b) of the Virgin Islands Revised Organic Act (codified at 26 U.S.C. § 7652(b)). Under this provision, _all_ of the excise taxes imposed on the manufacture of rum in the Virgin Islands were covered over to the Territory to finance capital projects.[1] During the years prior to enactment of the 1984 Tax Act, the cover-over provisions generated an average of $35 million a year for the construction of schools, roads, sewers and other vital projects.

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[1] The courts have interpreted this cover-over provision to apply only to taxes imposed on the _manufacture_ of products produced in the Virgin islands and not to taxes imposed on the _sale_ of such products. _See Commonwealth of Puerto Rico v. Blumenthal_, 642 F.2d 622 (D.C. Cir. 1980), _cert. denied_, 451 U.S. 983. Thus excise taxes imposed on the manufacture of rum -- the legal incidence of which falls in the Virgin Islands -- are covered over to the Territory, while excise taxes on the sale of gasoline are not.

Congress enacted the cover-over provisions in 1954 as part of the Virgin Islands Revised Organic Act -- a comprehensive statute establishing the Territorial Government and setting forth the legal relationship between the United States and the Virgin Islands. The cover-over provisions reflect a carefully crafted compromise that underpins the Federal-Territorial relationship and continues in relevance to this day.

The legislative history of those provisions reveals that the rum taxes covered over to the Virgin Islands were never intended to raise revenue, but rather to protect U.S. domestic manufacturers from Virgin Islands price competition as a result of its territorial status. In particular, since its acquisition from Denmark in 1917, the United States has generally exempted the Virgin Islands from the U.S. internal revenue laws. The special tax status of the Virgin Islands, however, raised the prospect that certain territorial products otherwise subject to an excise tax -- such as distilled spirits -- could be sold in the United States for significantly less than comparable U.S. products. In order to equalize the competitive position of U.S. and V.I. producers, Congress imposed on imports of such articles a tax "equal to the internal revenue tax imposed in the United States upon like articles of domestic manufacture."2/

The courts have also recognized that the tax imposed on rum manufactured in the Virgin Islands and shipped to the United States is not an ordinary excise tax but, rather, an "equalization" tax that would not be imposed but for the importation of such rum into the United States:

> [T]he... provision functions purely as an "equalization" provision. This is clear from both the purpose and the form of the statute. It was intended to equalize competition in those situations in which a [Virgin Islands] article being transported into the mainland market would have escaped a tax laid on similar domestic goods... because of the peculiar tax status of [the Virgin Islands].

Commonwealth of Puerto Rico v. Blumenthal, 642 F.2d at 628. Indeed, the court in Blumenthal, noting the "protectionist" nature of the equalization tax, distinguished it from a domestic tax "imposed on all goods alike after the goods enter the mainland market." Rather, the court observed, the equalization tax was more in the nature of a tariff -- in the court's words, a "condition of entry" into the United States. Id. at 636.

Because of the narrow purpose of the equalization tax and because of the need to ensure adequate revenues for the local government, Congress, in enacting the Revised Organic Act, deemed it fair and just that the proceeds of such taxes be covered over to the Virgin Islands. In this way, Congress was able to balance two important goals: the avoidance of direct taxation of the inhabitants or products of a non-voting, unincorporated territory, while protecting mainland producers from any unintended price competition engendered thereby.

THE TAX REFORM ACT OF 1984

As part of the Tax Act of 1984, Congress increased the excise tax on distilled spirits -- and thus the equalization tax on Virgin Islands rum -- from $10.50 a proof gallon to $12.50, but provided that the proceeds of the increase in the equalization tax would be covered into the U.S. Treasury rather than the Virgin Islands. However well intentioned the increase, the dollar cap imposed on the

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2/ Act of March 3, 1917, 39 Stat. 1132 (later codified in the Internal Revenue Code at at 26 U.S.C. § 7652(b)(1)).

cover over mechanism was a radical departure from the principles reflected in the Revised Organic Act and, in effect, subjected the manufacture of a product in the Virgin Islands to direct U.S. tax for the first time.

Quite apart from historic and constitutional issues raised by the cover over cap, the 1984 Tax Act has had significant impact on the Virgin Islands fiscal position. It is well documented that the increase in the excise tax has, since 1984, resulted in reduced demand for all distilled spirits, including rum. Industry figures show that last year alone, rum suffered a 7.2% decline in consumption -- approximately one million cases. In the Virgin Islands, the decline in national consumption since enactment of the excise tax increase has translated into a drop of 16% in V.I. rum shipments to the United States -- from 3.2 million proof gallons in 1984 to 2.9 million in 1985 and 2.7 million in 1986.

Because of the legislative cap on the cover over provision imposed as part of the 1984 excise tax increase, the decline in V.I. rum shipments has resulted in a corollary decline in territorial revenues. While V.I. excise tax collections averaged approximately $35 million a year between 1980 and 1983, collections dropped to $31.6 million in 1984 (the first year of duty-free competition from CBI eligible countries), and declined further to $30.4 million in 1985 and $28.6 million in 1986. Had the Virgin Islands obtained the cover over of the full amount of the equalization tax, the Virgin Islands would still have collected less than the average amount collected in the years immediately prior to the advent of CBI and the increase in the excise tax on distilled spirits.

THE BUDGET RECONCILIATION ACT OF 1987

Should the Congress determine that additional increases in the excise tax on distilled spirits are necessary to meet current budget targets, such increases will inevitably result in a further decline in consumption -- and, without modification to the cover over statute, further erosion in the fiscal base of the Virgin Islands Government.

Accordingly, the Government of the Virgin Islands submits that any increase in the excise tax should be accompanied by an elimination of the revenue cap imposed in 1984 on the cover over mechanism under 26 U.S.C. § 7652. Such modification would have a de minimus revenue effect on the U.S. budget process, but would provide significant remedial assistance to the fiscally pressed Islands Government. Indeed, if past experience is any guide, such a modification would barely -- if at all -- make the Government whole for revenues lost as a result of any decline in consumption. Moreover, elimination of the cap would be fully consistent with the position taken by this Committee during consideration of the excise tax increase in 1984, as well as with the historical purposes and antecedents of the cover-over law.

On behalf of the people of the Virgin Islands, I would like to thank the Members of this Committee for their past support on this issue and urge that the inequities of the 1984 Act be thus fairly resolved.

The
American
College of
Obstetricians and
Gynecologists

July 17, 1987

The Honorable Dan Rostenkowski
Chairman, House Ways and Means Committee
1102 Longworth Building
Washington, DC 20515

Dear Chairman Rostenkowski:

As the House Ways and Means Committee considers revenue options to meet the revenue targets set by the budget resolution, the American College of Obstetricians and Gynecologists (ACOG), an organization dedicated to improving the health status of this nation's women, urges you to support an increase in the cigarette excise tax from 16 cents to 32 cents a package.

The health hazards of smoking on women and their infants have been well-documented. Lung cancer has now surpassed breast cancer as the number one cause of death from cancer in women in some states, a trend which is expected to spread to all states. Smoking during pregnancy increases the risk of miscarriage and premature delivery. Newborns of mothers who smoke weigh on the average 7 ounces less than babies born to mothers who do not smoke. Low birth weight is directly correlated with infant mortality. In fact, babies weighing less than 5½ pounds are 40 times more likely to die during their first month of life. Despite these health hazards to both women and their infants, 28 percent of American women smoke cigarettes.

It is of particular concern to the ACOG that more teenage girls than boys now smoke. Statistics show that 60 percent of all new smokers are 14 years of age or less and that very few people start to smoke after the age of 21. A decrease in the number of individuals who currently smoke and those who may take up smoking would result from an increase in the cigarette excise tax. Studies indicate that a 10 percent increase in cigarette prices produces approximately a 4 percent decrease in smoking among adults and a 14 percent decrease among teenagers. Again, the ACOG urges you to increase the cigarette excise tax to 32 cents a package. This presents a unique opportunity for you to reduce the federal deficit while simultaneously benefitting the nation's public health.

Sincerely,

Harold A. Kaminetzky

Harold A. Kaminetzky, M.D., FACOG
Director of Practice Activities

HAK:L:gmp
Enclosure

600 Maryland Avenue, SW, Washington, DC 20024-2588 (202) 638-5577

ASIAN AMERICAN WOMEN IN BUSINESS

August 18, 1987

The Honorable Dan Rostenkovski
Chairman, House Ways & Means Committee
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Congressman Rostenkovski:

I am writing on behalf of AAWB to ask that you oppose proposals which would raise the excise tax on selected consumer products such as cigarettes. This would have an adverse effect on small businesses which are vulnerable to potential loss of sales.

We urge you to vote against narrowly-based levies that would affect a selected group of Americans.

Sincerely,

Pauline Tzuang

Pauline Tzuang
Chair
Communications Committee

APACC
Asian Pacific American Chamber of Commerce
1118 22nd Street, N.W., Suite 300
Washington, D.C. 20037 U.S.A.
Tel. (202) 659-4037

July 27, 1987

The Hon. Dan Rostenkowski
Chairman, House Ways and Means
Committee
1102 Longworth House Office Bldg.
Washington, D.C. 20515

Dear Congressman Rostenskowski:

The Asian Pacific American Chamber of Commerce (APACC), the umbrella organization of Asian American businesses, would like to go on record as being strongly opposed to any increase in federal excise tax on cigarettes. We object to the proposal because of the following reasons:

1. Excise taxes are regressive and are therefore an unfair burden on minorities. The Congressional Budget Office has reported that excise taxes bit hardest those that are least able to pay. Minorities make up a disproportionate amount of lower-income groups, and both groups make up a disproportionate amount of smokers. This means that an increase in excise tax would hurt minorities and lower income groups the most.
2. Excise taxes are arbitrary since they discriminate against consumers and producers of selected goods and services, and particular demographic groups.

If the package of excise taxes now being considered were passed, the gains that lower-income Americans received from the Tax Reform Act would be effectively wiped out.

APACC believes that Congress should adhere to the objective and spirit of the new tax reforms and reject proposals such as excise taxes on tobacco.

We hope that you will seriously consider our objections to the excise tax proposals.

Sincerely,

Benjamin G. Maynigo
National President

AMENY

Association of Minority Enterprises of New York, Inc.
165-40A BAISLEY BOULEVARD • SUITE 3 • JAMAICA, NEW YORK 11434 • (718) 341-0707

July 25, 1987

The Hon. Dan Rostenkowski
Chairman House Ways & Means Committee
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Representative Rostenkowski:

On behalf of the Board of Directors of **ASSOCIATION OF MINORITY ENTERPRISES OF NEW YORK, INC.**, I write to indicate our dissatisfaction with the proposed federal excise tax before Congress, which would double the current cigarette tax.

These regressive taxes offers the taxpayers no remedy for inflation. The Congressional Budget Office has demonstrated the detrimental impact that these excise taxes have on people, particularly on the poor.

The increased costs imposed upon smokes will unavoidably lead to a decrease of sales, which will result ultimately in loss of jobs. The cycle occurred previously in 1983, and with the given circumstances will repeat itself.

We urge you to do everything in your power to oppose this biased and cataclysmic excise tax.

Sincerely,

Lynda Ireland
President

WRITTEN STATEMENT FOR THE RECORD OF W. BEN CRAIN

ON BEHALF OF THE BURLEY AUCTION WAREHOUSE ASSOCIATION

The Burley Auction Warehouse Association appreciates the opportunity to submit this written statement in opposition to any increase in the federal excise tax on tobacco products.

The members of this association have a unique position from which to view the effects of this excise tax. We operate the warehouses in which burley tobacco farmers market their tobacco. We are acutely aware of the level of purchases by tobacco manufacturers and how well a farmer is doing by his level of sales.

In 1982, when Congress temporarily doubled the excise tax from 8 cents to 16 cents, our association watched the subsequent sale of leaf tobacco immediately decrease. In 1983, the sale of cigarettes declined by 6%. Unfortunately, this reduction coincided with the 1983 drought year for burley tobacco farmers. The resulting economic depression was felt throughout Kentucky and other major burley markets.

Fortunately, steps have been taken to place the American burley farmer in a position where he can, once again, legitimately expect to make a profit from the sale of tobacco. In addition, the prospects of further openings in the international markets are excellent. Burley farmers, although far from being wealthy, are optimistic about being able to service their loan obligations, their quotas being increased and being able to subsidize the balance of their farm operations with the profits from tobacco.

An increase in the tobacco excise tax from 16 cents to 32 cents will immediately put an end to the farmer's optimism. Within the next two years, it is anticipated that the greater percentage of American cigarettes will be made from American tobacco. The decreased dependence on imported tobacco will accrue direct benefit to the American tobacco farmer.

An increase in the tax will cause similar, if not greater, reductions in the need for American tobacco than accured in 1982. We realize several proponents of an increase appreciate, if not encourage, that fact. Nevertheless, the members of our Association are a prime example of the ripple effect of tobacco in the southeastern economy. Although many of our members do not actually produce tobacco, we depend directly on its production and marketing for our livlihoods. There are many other industries similarly situated and this committee must address the adverse economic harm which inevitably will occur if the tobacco tax is increased.

We thank the committee for its consideration of our views and urge its members to oppose any increase in the tobacco excise tax.

REMARKS OF THE HONORABLE DAN DANIEL,
OF VIRGINIA
BEFORE THE HOUSE WAYS AND MEANS COMMITTEE
ON CIGARETTE EXCISE TAXES

WEDNESDAY, JULY 15, 1987

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

Raising taxes is always an onerous task -- even under the best of circumstances, but when an individual or an industry is perceived to be paying more than its share, it is only reasonable that objections be heard.

The cigarette industry only recently had its permanent tax rate doubled -- from eight to 16 cents per pack as part of the 1986 Tax Bill. Proposals to double this again -- or to make a substantial increase would pose an unfair burden on segments of the economy at the lowest level of income.

Already, taxes make up more than 30 percent of the cost of cigarettes and this is significantly higher than most consumer items. In the last fiscal year, the Federal government derived $4.4 billion from cigarette taxes. More than $9.2 billion was raised from taxes by all levels of government.

Recently, nine states have increased their cigarette taxes. It is highly unlikely that these states, nor any others, are going to reduce their's if the Federal government hikes cigarette taxes.

But there is more to this than simply the amount of taxes that would be raised. Large sections of the United States derive a good bit of their income from the growing, processing and manufacturing of tobacco and tobacco products. Certainly, at the growing level, producers of tobacco are hard-pressed by high production costs. To make this burden more severe without considering the circumstances is to apply confiscatory taxation.

I appeal to Members of this Committee to take into account the difficulties through which growers will be forced if there is any substantial increase in the tobacco tax. What do we gain, if through expediency we tax to the point of disaster, so that less taxes are paid?

ICBO

August 24, 1987

The Honorable Dan Rostenkowski
Chaiman Hous Ways & Means Committee
1102 Longworth House Office Building
Washington, D.C. 20515

I would like to call your attention to our opposition to recent proposals to double the federal excise tax on cigarettes.

We feel that excise taxes are an inequitable imposition on the public, especially those segments of the public composed of lower-income and poverty group members, and a repudiation of the recent Tax Reform Act, which attempts to distribute tax liability more fairly.

Tobacco excise taxes are the most inequitable of all, as shown by the recent Congressional Budget Office working paper, THE DISTRIBUTIONAL EFFECTS OF AN INCREASE IN SELECTED FEDERAL EXCISE TAXES.

This document, prepared at the request of Maine's Senator George Mitchell and distributed in January of this year, forcefully demonstrates that tobacco excise taxes impact on poor families fifteen times as much as they do on families earning $50,000 a year or more.

According to the Congressional Budget Office, "an increase in the excise tax on tobacco would be the most regressive of all the tax increases considered."

In light of these facts, we respectfully request that you vote against increasing excise taxes.

Thank you for your time in considering our side of this vitally important issue.

Very truly yours,

Malcolm L. Corrin
Vice Chairman

INTERRACIAL COUNCIL FOR BUSINESS OPPORTUNITY
800 Second Avenue Suite 307 New York, N.Y.10017 (212) 599-0677

John Middleton
INCORPORATED
MANUFACTURERS OF FINE TOBACCOS SINCE 1856
KING OF PRUSSIA • PENNSYLVANIA • 19406

HERBERT H. MIDDLETON, JR.
PRESIDENT

July 14, 1987

Honorable Dan Rostenkowski
House Ways & Means Committee
1102 Longworth House Office Bldg.
Washington, DC 20515

RE: Ways and Means Committee hearings on Options for Taxing Tobacco Products (July 7-9, 1987)

Dear Congressman Rostenkowski:

While we strongly oppose all of the various options to increase the excise taxes on all tobacco products, we are most especially disturbed by the addition of an option concerning a 48¢ per pound tax proposal on Smoking Tobaccos.

There is currently no federal tax on Smoking Tobaccos. Placing one on smoking tobaccos now, most especially in the magnitude of 48¢ per pound, would have these most deleterious effects:

1. It would be regressive in that the largest proportion of those smoking pipe tobaccos are older males, many, if not most of whom, are on pensions or fixed incomes. (This category does not attract young people.)

   A Prince Albert smoker who now buys a 14-ounce tin of the product pays $6.73 (with normal mark-up) would pay at least $7.32 if the 48¢ per pound were to go into effect. I say at least because there are significant costs in administering and paying these taxes which will naturally have to be added and passed on to the consumer.

2. There is a belief that such a tax would produce substantial revenues, as much as $100,000,000 annually. In actuality, smoking tobaccos sales in 1986 produced a total of 20,576,000 (15,623,000 for domestic tobaccos and 4,953,000 for Imports). This would provide less than ten million dollars in tax revenues.

3. The Smoking Tobacco industry has suffered tremendous declines in recent years. In the past ten years, consumption has declined 56.1%. It has been off every year since 1984 by more than ten percent per year, and right now it is running at -20.4% behind last year's first quarter results. This new tax could be the demise of an industry that is disappearing all by itself.

We fervently hope that the option concerning Smoking Tobacco will not go forward as a recommendation.

Yours truly,

John Middleton, Inc.

Walter G Fitzgerald

Walter G. Fitzgerald
Vice President, Marketing

DOMESTIC AND IMPORT PIPE TOBACCO CONSUMPTION IN 1951, 1966 to 1986
(in M Pounds)

	Domestic		Import		Total		Import %
Year	M Lbs.	% Chg	M Lbs.	% Chg	M Lbs.	% Chg	Share of Mkt.
1950	93,302		64		95,366		
1) 1951	88,834	- 6.8	54	-15.6	88,888	- 6.8	0.001
1965	59,314	-15.8	2,490	-16.8	61,804	-15.8	4.03
2) 1966	57,668	- 2.8	3,268	+31.2	60,936	- 1.4	5.36
1967	55,295	- 4.1	3,681	+12.6	58,976	- 3.2	6.66
1968	56,727	+ 2.6	5,609	+52.4	62,336	+ 5.7	9.00
1969	55,616	- 2.0	5,737	+ 2.3	61,353	- 1.6	9.35
1970	54,699	- 1.6	8,227	+43.4	62,926	+ 2.6	13.07
1971	49,005	-10.4	8,170	- 0.7	57,175	- 9.1	14.29
1972	45,548	- 7.1	11,680	+43.0	57,228	+ 0.1	20.41
1973	43,369	- 4.8	7,841	-32.9	51,210	-10.5	15.31
1974	41,661	- 3.9	9,945	+26.8	51,606	+ 0.8	19.27
1975	38,869	- 6.7	8,499	-14.5	47,368	- 8.2	17.94
1976	37,906	- 2.5	9,881	+16.3	47,787	+ 0.9	20.68
1977	35,216	- 7.1	6,888	-30.3	42,104	-11.9	16.36
1978	31,400	-10.8	8,877	+28.9	40,277	- 5.9	22.04
1979	28,820	- 8.2	6,946	-21.8	35,766	-11.2	19.40
1980	27,319	- 5.2	6,768	- 2.6	34,087	- 4.7	19.90
1981	26,774	- 2.0	6,580	- 2.8	33,354	- 2.2	19.70
1982	24,527	- 8.4	6,065	- 7.8	30,592	- 8.3	19.80
1983	22,975	- 6.3	6,700	+10.5	29,675	- 3.0	22.60
1984	20,567	-10.5	5,926	-11.6	26,493	-10.7	22.40
1985	18,091	-12.0	5,378	- 6.4	23,469	-10.8	22.92
1986	15,623	-13.6	4,953	- 7.9	20,576	-12.3	24.07

* First quarter 1987 shows total pounds - 20.4% from first quarter 1986.

Federal excise tax reduced: 1) 18¢/Lb. to 10¢ 2) 10¢/Lb. to 0.

OFFICE OF THE GOVERNOR
FRANKFORT, KENTUCKY 40601

MARTHA LAYNE COLLINS
GOVERNOR

July 10, 1987

The Honorable Dan Rostenkowski, Chairman
US House Ways and Means Committee
2111 Rayburn House Office Building
Washington, D.C. 20510

Dear Mr. Chairman:

Farmers who rely on tobacco for a major part of their income are already bearing their share of the burden in efforts to reduce the federal deficit, the doubling of the federal excise tax on cigarettes from eight to sixteen cents being a prime example.

Furthermore, farm income from tobacco has dropped by 48 percent since 1982. Coupled with the more general troubles that have put America's farmers in the worst financial straits since the Great Depression, this drop is devastating Kentucky's small farmers. Another doubling of the excise tax would inflict yet further damage on them and their families.

We have seen the "temporary" increase to sixteen cents become a permanent one. One such increase is enough. The proposed increase from sixteen to thirty-two cents should be blocked.

Sincerely,

Martha Layne Collins

AN EQUAL OPPORTUNITY EMPLOYER M F H

Korean-American Chamber of Commerce Inc.
25 WEST 32 ST., SUITE 401
NEW YORK, N.Y. 10001
TEL: (212) 695-4045/7

JULY 25, 1987

The Hon. Dan Rostenkowski
Chairman House Ways and Means Committee
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Congresman Rostenkowski:

The Korean American Chamber of Commerce is opposed to proposals now before Congress that would double the Federal cigarette tax.

We represent small Korean business. We note that this tax has been doubled within the last four years. The state and city governments have also increased this tax. This is a tax on the poor. It is wrong.

I hope you will take our views into consideration.

Sincerely,

O. Yoon Kwon
President
Korean American Chamber of Commerce

114 Bruce Drive
Cary, NC 27511
August 17, 1987

Mr. Dan Rostenkowski
Chairman
Committee on Ways and Means
1102 Longworth House Office Bldg.
Washington, DC 20515

Dear Mr. Rostenkowski:

I would like to raise my voice along with many, many other Americans with regard to proposals to increase the excise tax on cigarettes. I recognize that we are all living with deficit spending and that fiscally that just doesn't make any sense. However, I am very conscious of the fact that cigarettes and other tobacco products are already taxed at an unusually high rate and frankly I think enough is enough.

As you well know, it was only a little more than a year ago that Congress doubled the federal excise tax. To consider further increases now, puts in jeopardy jobs currently held by those who work with tobacco...from the farmers, the manufacturers and the retail and wholesalers.

My smoking and non-smoking friends alike and I urge that you consider other revenue raising schemes rather than raising the excise tax on tobacco.

Sincerely,

July 17, 1987

The Hon. Dan Rostenkowski
Chairman of The House Ways
and Means Committee
1102 Longworth House Office Bldg.
Washington, D.C. 20515

Dear Senator Rostenkowski,

The National American Indian Council is an organization serving the needs of over three hundred (300) American Indian organizations and Tribes located off the reservation. It has been brought to our attention that there is a move, again, to raise the excise tax on cigarettes. We understand that if passed, the current tax would be doubled. We are firmly against congress raising excise taxes on any consumer goods because excise taxes lower sales and raise the price of items. Also, these taxes are regressive and the poor always pay disapportionately.

Thank you for your assistance and we look forward to your reply.

Sincerely,

Barry Richardson

Barry Richardson
NAIC Governing Board

GREATER NEW YORK CHAPTER
NATIONAL ASSOCIATION OF MARKET DEVELOPERS, INC.

August 11, 1987

The Honorable Dan Rostenkowski
Chairman
House Ways & Means Committee
1102 Longworth House Office Bldg.
Washington, DC 20515

Dear Representative Rostenkowski:

It has come to the attention of the Greater New York Chapter, National Association of Market Developers that you are chairing the committee which will consider proposed legislation to double the federal excise tax on cigarettes.

The Greater New York Chapter, National Association of Market Developers would like you to know that we strongly oppose the passage of this legislation, as we oppose the passage of any law that would increase the excise tax on cigarettes, or any other consumer product.

We believe that excise taxes are randomly discriminatory, that they are economically destructive and that they place an unfair tax burden on the poor.

For these reasons, among others, we ask that you join us in opposing any increase in the federal cigarette excise tax.

Yours,

Jinni Rock-Bailey
President

800 Second Avenue • Suite 1309 • New York, NY 10017

National Association of Minority Women In Business
P.O. Box 26412, Kansas City, MO 64196
(816) 421-3335

MRS. INEZ KAISER
President

July 27, 1987

Hon. Dan Rostenkowski
Chairman of the House Ways & Means Committee
1102 Longworth House Office Bldg.
Washington, D.C. 20515

Re: H. Con. Res. 93

Dear Hon. Rostenkowski:

As the National President of the National Association Of Minority Women In Business I wish to express my strong opposition to the proposal that would double the Federal Excise Tax on cigarettes. It is my belief that every American is aware of the need to have our current Federal Budget Deficit controlled, but it is my belief that this should not be done by imposing an unfair burden on minorities and under privileged people. There should be some other method devised to address this important issue.

The increase in excise tax affects Blacks, Hispanics, other minorities and other individuals who are unemployed much more than it does those individuals who are in the higher income level. It would appear that some other form of taxes which would be more equitable should be imposed so that those who earn more will be taxed according to their income. The impact of an increase in Federal Excise Taxes on low income individuals would have as much as three times the impact as on higher income people. The burden should certainly be distributed accordingly among all people and not legated to one particular class.

May I ask that you give serious consideration to identifying a just method of taxation and oppose this regressive measure.

Sincerely,

Dr. Inez Y. Kaiser, National President
National Association of Minority Women In Business

IK:ems

The National Association of
Negro Business and Professional Women's Clubs, Inc.

1806 NEW HAMPSHIRE AVENUE NW • WASHINGTON, D.C. 20009

Telephone: Area Code 202 — 483-4206

NATIONAL OFFICERS

NATIONAL PRESIDENT
FRANKIE JACOBS GILLETTE
85 Cleary Court #4
San Francisco, CA 94109
415-563-8299

FIRST VICE PRESIDENT
DORIS F. JOHNSON
100 Fort Washington Avenue
New York, NY 10032
212-928-2433

SECOND VICE PRESIDENT
BRENDA L. SPENCER
P.O. Box 5814
Youngstown, OH 44504
216-743-5921

RECORDING SECRETARY
TAMRA G. MARSH
251 W. DeKalb Pike A-510
King Prussia, PA 19406
215-477-7466

TREASURER
MARY C. MURRAY
9321 Greyrock Road
Silver Spring, MD 20910
301-588-4663

DIRECTOR FOR COMMUNICATIONS
MARETTA M. TAYLOR
1203 Bunker Hill Road
Columbus, GA 31907
404-687-8190

DIRECTOR OF MEMBERSHIP
CATHERINE SYKES
1172 Eckman Street
Pontiac, MI 48057
313-373-6957

DIRECTOR OF RESOURCES
JACQUELIN B. GATES
1019 Van Siclen Avenue #5J
Brooklyn, NY 11207
718-257-3205

DIRECTOR FOR YOUTH AND YOUNG ADULT AFFAIRS
ADRIAN BYRD
20 Fairlawn Avenue #D-1
Mattapan, MA 02126
617-298-2644

DIRECTOR OF EDUCATION
GAIL CONNER
2062 Hyde Park Drive
Detroit, MI 48207
313-393-1311

July 21, 1987

The Honorable Dan Rostenkowski
Chairman, House Ways and Means
Committee
1102 Longworth House Office Bldg.
Washington, D. C. 20515

Dear Sir:

I am writing to express opposition to bills which would double the federal excise tax on cigarettes. We do not look favorably on tax proposals which place a greater share of the burden on the poor than they do on wealthier Americans.

There is too much inflation. Excise taxes contribute to inflation by artifically raising the price of certain products. Low-income Americans can ill-afford such artificial price increases. It is unfair to single out a particular group of consumers and force them to finance government services which benefit the entire population.

Revenue-raising measures should be progressive and broadly-based. Although it often requires more political courage to support such measures than it does "hidden" taxes like the excise tax, in the long run, both government and citizens benefit. I hope the committee will reject the excise tax in favor of fairer and more stable means of raising revenue.

Very truly yours,

Frankie Gillette

Frankie Jacobs Gillette
National President

NATIONAL ASSOCIATION OF REAL ESTATE BROKERS, INC.

Executive Mailing Address
P.O. Box 56483
Washington, D.C. 20041-6483
Telephone 202-289-6655

T.L. "Thom" Holmes
President

July 27, 1987

The Honorable Dan Rostenkowski
Chairman
House Ways and Means Committee
1102 Longworth House Office Building
Washington, DC

Dear Senator Rostenkowski:

Currently, your committee is considering (HR 260) (S 447), a proposal to raise the federal excise tax on tobacco products and gasoline. I, Thom L. Holmes, President and Chief Executive Officer of the National Association of Real Estate Brokers, representing more than 15,000 real estate professionals, would like for the records to reflect that we are firmly opposed to any such increases.

Excise taxes are regressive, unfair and place a damper on the functioning of the free market. The National Conference of State Legislators estimates that over a five year period, the states stand to lose over $4 billion dollars if the federal gas tax is raised by 12 cents, and over $1.3 billion dollars if the federal cigarette tax is doubled. That clearly indicates diminishing all revenues for a state.

We would like to further point out that businesses owned by minorities are likely to experience a substantial adverse impact from the proposed increase in the tax. Cigarettes and similar convenience items are important factors in attracting customers to small businesses and neighborhood stores. These establishments would be affected disproportionately by any loss of sales resulting from artificially high prices.

For these reasons, we ask that you oppose any increase in the federal excise tax on cigarettes and gasoline.

Sincerely,

Thom L. Holmes
President

TLH/drb

NMBC

NATIONAL MINORITY BUSINESS COUNCIL, INC.
235 East 42nd Street, N.Y. 10017, Tel (212) 573-2385

July 22, 1987

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President & C.E.O.
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Brownie W. Davis Agency, Inc.
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Certified Public Accountants

Legal Counsel
Raymond Falcon, Esq.
David Hom, Esq.

**Chairman, Executive Committee
*Executive Committee Members

Founded 1972

The Hon. Dan Rostenkowski
Chairman House Ways & Means Committee
1102 Longworth House Office Bldg.
Washington, D.C. 20515

Dear Mr. Rostenkowski:

Excise tax increases have been touted as a panacea for our nation's budget ills, but in our view this is a case of the cure being worse that the disease. Currently, our committee is considering proposals to raise the federal excise tax on tobacco products. Although we agree that the budget deficit must be reduced as quickly as possible, we are also concerned that this reduction be achieved fairly.

Raising excise taxes puts the weight of deficit reduction squarely on the backs of the poor. The Congressional Budget Office has estimated that, as a percentage of income, excise tax rates are as much as 15 times higher for low-income families than for wealthier households. Certainly, it is unfair to make poor Americans shoulder a greater burden than those who are more fortunate. It is also unfair to make consumers of particular products contribute a significantly greater portion of their incomes to revenues that are put to general uses.

We believe that excise taxes are an unfair, unstable and undependable means of raising federal revenues. Our nation's financial security is too important to rest on what are, in effect, selectively imposed sales taxes. We hope that the committee will reject excise tax increases in favor of sounder methods of raising revenue.

Sincerely,

John F. Robinson
President & C.E.O.

JFR:mr

NMBC National Minority Business Council, Inc.
235 East 42nd Street, New York, N.Y. 10017
Tel (212) 573-2385

STATEMENT OF PURPOSE
and
FACT SHEET

Purpose
The National Minority Business Council, Inc. ("NMBC") is a not-for-profit 501(c)(3) corporation founded in December, 1972 as a procurement, advocacy, educational and training organization servicing minority vendors in not only the greater New York, New Jersey and Connecticut metropolitan areas, but also in various regions throughout the country. The primary purpose of the NMBC is to develop the marketing, sales and management skills of its membership with the objective of increasing their overall profitability. The secondary purpose is to act as a spokesunit and information source for the minority business community nationally.

Organization
The NMBC is an umbrella organization that encompasses 200 small businesses primarily located in the tri-state area, and has developed programs and services for the interest and benefit of these small business entrepreneurs, e.g., the Corporate Minority Vendor Directory, a Legal Services Plan, publication of Better Business and NMBC Update magazines, a Business Referral Service, the International Trade Assistance Program, the Continuing Management Education/Executive Banking/Purchasing Exchange Programs, and a Group Insurance Plan.

Structure
The NMBC is governed by a Board of Directors, an Executive Committee, an Advisory Council comprised of outside corporate and business professionals, a Membership Planning Committee composed of the membership minority business owners, and a newly-formed Management Advisory Committee (a group of retired management executives who will donate their expertise to help solve members' problems).

Support
The NMBC is a private sector initiative funded by membership dues and contributions from major corporations and foundations. The Annual Awards Luncheon is the major fundraising event, which represents another commitment on the part of the NMBC to bring together corporations and minority enterprises "to do business."

Minority Participation
The NMBC's servicing base has expanded from a membership of 20 to approximately 300+ vendors nationwide in addition to increased participation in important NMBC affairs by the Membership Planning Committee.

Accomplishments
The NMBC has produced an effective self-helf program to overcome handicaps of minority and small businesses. Constant penetration of corporate purchasing departments has resulted in increased procurement, the development of a new Management Training Program with Nynex, computerization of the Corporate Minority Vendor Directory for distribution to major corporations across the country, and a focus that has become national in scope have all contributed to the realization of the main objective -- increased profits.

For further information, please contact our office at (212) 573-2385.

Statement of Dr. T. Carlton Blalock, Executive Vice President

The Tobacco Growers Association of North Carolina, Inc.

Presented to

The House Committee on Ways and Means

July 9, 1987

I am T. Carlton Blalock, Executive Vice President of the Tobacco Growers Association of North Carolina, Inc. We represent both burley and flue-cured tobacco farmers. The majority of them are full-time, active growers who depend upon this crop to support their family. Therefore, the issue of whether to further increase the federal excise tax on cigarettes is of vital concern to them. In fact, they will probably experience the greatest economic loss of any segment of the industry if you raise the cigarette excise tax.

Our Association led the fight to revamp our tobacco program last year. We convinced farmers that we had to reduce our prices in order to become more price/quality competitive in the world market. We also persuaded them to accept a new quota setting mechanism that would be more responsive to market demands, avoid the excessive build up of loan stocks and the double digit assessments necessary to carry those stocks.

The 1986 market proved we have a new program that will work if given time. Tobacco farmers are optimistic about their future for the first time in many years. They have seen a recovery in the value of their land and tobacco quota. Two years ago, many young tobacco farmers found themselves in a situation where, after servicing a loan on a farm they had purchased several years earlier, could not be sold for enough to satisfy the remaining debt. The equity value of tobacco quota in North Carolina had declined by at least $.5 billion. Tobacco farmers had seen the value of their land go down at least three times that much. All of that has changed as a result of this new program and you now find an entirely different economic situation with tobacco farmers in our state.

If Congress doubles the federal excise tax on cigarettes, you will wipe out this improvement and many of those farmers who successfully fought off bankruptcy two years ago will fall victim this time. In essence, you will devastate the rural economy of our state. We can speak with certainty, because we saw what happened the last time this tax was doubled. Consumption will again go down, quotas will be drastically cut, loan takes will increase and assessments will soon reach double digits. Tobacco farmers will feel, and I believe justifiably so, that they have again been misled by their leaders. Their faith in our government's commitment to fairness will be further deminished.

You must remember that tobacco farmers do not get a government subsidy as do the producers of many commodities. In fact, they feel through the $10.5 billion in excise taxes collected by federal, state and local treasuries, that they subsidize government.

Since 1982, tobacco farmers have been required to pay an assessment to operate their program and assure the federal government that it will incur no loss. In 1985, this assessment reached 25¢ for every pound of tobacco the farmer grew, or the equivalent of $500/acre! The President of our Association that year grew 100 acres of tobacco. His assessment amounted to $50,000. It became the straw that "broke the camels back." He sold his home and he almost lost his farm. As you can imagine, he becomes incensed when the media talks about "the tobacco subsidy". Under this new program, however, he's going to make it. His land values have gone back up. His quota is worth twice what it was in 1985 and the financial institutions are willings to loan him operating money in 1987. He's but one example of thousands of others just like him in our state.

On behalf of our members, we plead with you to reject any proposed increased in the federal cigarette excise tax. It will negate the bipartisan effort of Congress when it passed the Tobacco Reform Act of 1986. You will destroy the delicate balance between supply and demand that we're beginning to achieve under this new program. In so doing, you will also take away the new stability we've achieved in the past twelve months in this industry and once again dash the hopes of tobacco farmers that they can see a return to profitability on their farm. Tobacco is one segment of our agricultural economy where we have been able to turn things around as a result of action by the Congress. It makes little sense, to our members in particular, for this same Congress to take action that will certainly wipe out all of these gains and force us to again look for ways in which our federal government can offer some relief to tobacco farmers.

TESTIMONY OF
CHARLES O. WHITLEY
ON BEHALF OF
THE TOBACCO INSTITUTE
BEFORE THE HOUSE COMMITTEE ON WAYS AND MEANS
JULY 9, 1987

Mr. Chairman, distinguished members of the Committee and former colleagues. I appreciate the opportunity to appear before you today to address the issue of a possible increase in the federal excise tax on tobacco products.

The list of revenue options prepared by the Joint Committee on Taxation (JCT) and the committee staff includes several proposals for increasing the tobacco excise tax, and I would like to address the arguments listed in the proposal in support of any increase.

The JCT print states that the most recent increase in the federal excise tax on tobacco occurred in 1982 and that had the tax been indexed to the CPI since its inception in 1951, it would be approximately 34¢ per pack today.

The most recent increase in the tobacco excise tax occurred on April 7, 1986 when the President signed the FY 1987 reconciliation bill. That legislation made permanent the 16¢ per pack level which was scheduled to expire on September 30, 1985 in accordance with the sunset provisions enacted in 1982 when the tax was temporarily increased from 8¢ to 16¢ per pack.

In any event, the argument in support of indexing this excise tax to the CPI is totally without merit. In the first place, the argument fails to acknowledge, much less address, the authority which has been actively utilized by state and local governments to impose similar excise taxes on tobacco products. In addition to the federal tax of 16¢ per pack on cigarettes, each state and 388 localities impose some form of excise tax on tobacco products. A list of the current levels of excise tax imposed by each state is attached. The average state and local tax is 22¢ per pack. Combined with the federal tax, the average total tax on tobacco products is 38¢ per pack. The Joint Committee print suggests that an indexing since 1951 would place the current tax level at 34¢ per pack. If the entire realm of taxation is reviewed, as it should be in addressing this question, it is apparent that the tax burden on tobacco has exceeded the level of inflation since 1951.

More fundamentally, I know of no logical reason for indexing the tax on this or any other product in order to keep pace with inflation. In fact, indexing taxes to inflation, simply assures more inflation, certainly not a desirable economic goal. The Committee print refers to retaining "the real tax burden of these taxes". Individuals who choose to purchase tobacco products experience a "real tax burden" each time they buy the product. Each year, approximately $10 billion in excise taxes is paid by the consumers of tobacco products. Approximately half of this amount is paid to the federal government. This is $10 billion over and above the personal income tax and other taxes paid by these consumers to the federal and state governments.

Furthermore, history shows that when the federal government increases the level of excise tax on this product, many states, anticipating a decline in sales, immediately enact similar increases in order to maintain existing levels of revenue from these taxes. This year, approximately 35 states have or will consider legislation increasing the excise tax on tobacco products.

A list of the states and respective proposals is attached. If the federal government increases taxes on tobacco products, it must do so with the knowledge that the tax burden for consumers will, more likely than not, be similarly increased at the state and local level as well.

The next argument in support of an increase offered by the Committee print is that despite the regressive nature of an excise tax, purchase of tobacco products by an individual is discretionary and, as such, lessens the regressive impact of the tax. In January of this year, the Congressional Budget Office, at the request of Senator George Mitchell, examined the distributional effects of an increase in selected federal excise taxes. The study looked at separate increases in the excise tax on seven commodities: beer, wine, liquor, tobacco, gasoline, airfare, and telephone service. Lest there be any doubt as to the regressivity of excise taxes in general and specifically the tax on tobacco, I quote the conclusion reached by CBO:

> "An increase in the excise tax on tobacco would be the most regressive of all the tax increases considered."

My experience as a member of the House and as a private citizen is that a tax is a tax, regardless of how it is imposed or on what product it is placed. Is a sales tax on food items such as cookies or candy any less regressive because it could be classified as a "discretionary item?". I do not think the purchaser of the product would think it is less regressive. In attempting to make the distinction between what is necessary and what is discretionary, we risk crossing the fine line between the right to choose in a free market and government regulation of individual behavior. An individual who has made an informed choice on whether to purchase a product should not be penalized with an additional tax burden because of his choice.

The Joint Committee print also states that an increase in the excise tax could be used to offset costs of administering programs of the Bureau of Alcohol, Tobacco, and Firearms. The current revenue from the tobacco excise tax, approximately $5 billion, goes to the general revenue fund of the treasury and is then disbursed through the normal appropriation process of Congress. This committee has been hesitant, and rightfully so, to earmark portions of existing excise taxes. Given the mandate under the budget resolution of increasing revenue to reduce the federal deficit, I would suggest that implementing a new earmarking of this tax would make that task even more difficult.

In the most recent reconciliation law, the time allowed for electronic transfer of excise taxes for tobacco products was decreased, thus allowing the government to realize additional funds from longer interest periods. This change, in addition to the tobacco manufacturers' exemplary tax compliance record, offsets any arguments in support of an increase to pay for the administration costs of the bureau.

I now turn to several points not readily apparent to committee members, but ones which should be considered. The Third District of North Carolina, which I was priviledged to represent, produces more tobacco than any other congressional district in the country. Absent each of you visiting the district for an extended period of time, it is impossible to convey the economic importance of tobacco to that area and the entire state. For some, tobacco is a controversial and sometimes an emotional issue. Regardless, it remains an issue which impacts hardworking Americans.

Tobacco growers and manufacturers have learned to work together to address current and potential problems in order to maintain this viable segment of American agriculture. The result of this work is a strong, yet somewhat delicate, program which would be disrupted by an increase in the federal excise tax on tobacco.

In addition to reducing the deficit, this committee is concerned with the American trade situation. Within the past two years, growers and manufacturers have addressed their own trade problems. The tobacco farmers have agreed to several major changes in the tobacco program including a significant decrease in price making their product more competitive in both the domestic and international markets. Manufacturers have agreed to purchase surplus American tobacco stocks and individual manufacturers have voluntarily agreed to decrease purchases of imported tobacco for use in domestic products.

An increase in the excise tax could negate the economic benefit of these actions. The tobacco industry currently contributes $2.7 billion to the positive side of the U.S. trade. I do not believe we can afford to enact legislation which penalizes a segment of our economy which is taking voluntary action to address its own concerns.

I can state without hesitation or doubt that next to the consumer, the American tobacco farmer will suffer most from such legislation. Tobacco is a cash crop in the truest sense of the word. It is good business practice for a farmer in some geographic regions to grow tobacco. In many instances, the production of tobacco enables the farmer to finance other operations on his farm. An increase in the excise tax will result in less tobacco being produced and sold by the American farmer. There are no acceptable alternatives for most tobacco farmers to make up for the loss in income. This, of course will have a ripple, if not wave, effect in communities throughout the southeastern United States which depend on this commodity as their economic backbone.

Congress is faced with tremendous problems in attempting to keep American agriculture viable. Tobacco production is a proud profession and one which has shown the ability to deal with its own problems. The dilemma facing the American farmer will be accelerated if this committee increases the excise tax on tobacco products.

In conclusion, I refer the committee to the final paragraph of the June 24th editorial of The Boston Globe:

> "The pressure to find more revenues should not blind Congress to a central objective of tax policy: fairness based on ability to pay. Relying too heavily on excise taxes betrays that aim."

STATE CIGARETTE EXCISE TAX RATES

(cents per 20-pack)

North Carolina	2	Mississippi	18
Virginia	2.5	Oklahoma	18
Kentucky	3	Pennsylvania	18
South Carolina	7	Colorado	20
Wyoming	8	Illinois	20
California	10	Texas	20.5
Indiana	10.5	Arkansas	21
Georgia	12	Michigan	21
Maryland	13	New York	21
Missouri	13	Utah	23 [a]
Tennessee	13	South Dakota	23
Delaware	14	Minnesota	23
Ohio	14	Florida	24
Nevada	15	Kansas	24
New Mexico	15	Rhode Island	25
Arizona	15	New Jersey	25 [b]
Alaska	16	Wisconsin	25
Louisiana	16	Massachusetts	26
Montana	16	Iowa	26
Alabama	16.5	Connecticut	26
New Hampshire	17	Nebraska	27 [c]
Vermont	17	North Dakota	27 [d]
Dist. of Columiba	17	Oregon	27
West Virginia	17	Maine	28
Idaho	18	Hawaii	29 [e]
		Washington	31

[a] Rate includes 11 cent increase effective 4/27/87
[b] Includes surtax escalator; 19 cent excise + 6 percent surtax
[c] Rate includes 4 cent increase effective 7/1/87
[d] Rate includes 9 cent increase effective 7/1/87
[e] Rate is 40% of wholsale price

STATE LEGISLATION IN 1987 TO INCREASE EXCISE TAX ON TOBACCO PRODUCTS

State	Proposed change	Status
Alabama	+10¢	Pending
California	+25	Pending
Connecticut	+ 1 percent ad valorem	Rejected
Florida	+ 1	Rejected
Hawaii	+12	Rejected (Tax is ad valorem, so increases w/price)
Idaho	+8.9	Raised 8.9¢ eff. 4/1/87
Indiana	+ 5	Raised 5¢ eff. 7/1/87
Iowa	+10	Rejected
Massachusetts	+ 8	Pending
Michigan	+ 5	Rejected
Minnesota	+18	Raised 15¢ eff. 6/1/87
Mississippi	+ 1	Rejected
Missouri	+ 8	Rejected
Montana	+10	Rejected
Nebraska	+ 4	Raised 4¢ eff. 7/1/87
Nevada	+ 5	Raised 5¢ eff. 7/1/87-6/30/89
New Hampshire	+ 1	Rejected
New Jersey	+ 5	Pending
New York	+ 3	Pending
North Dakota	+ 9	Raised 9¢ eff. 7/1/87
Ohio	+ 5	Raised 5¢ eff. 7/15/87
Oklahoma	+ 5	Raised 5¢ eff. 6/1/87
Oregon	+10	Rejected
Pennsylvania	+ 2	Pending
South Carolina	+10	Rejected
South Dakota	+ 5	Rejected
Texas	+9.5	Pending
Utah	+11	Raised 11¢ eff. 4/27/87
Washington	replace with ad valorem	Rejected
West Virginia	replace with 28% ad valorem	Rejected
Wisconsin	+ 5	Pending

ROBERT D. TOLLISON
2515 N. BUCHANAN ST.
ARLINGTON, VIRGINIA 22207

Statement of
Dr. Robert D. Tollison
Professor of Economics
George Mason University

Before the House Ways and Means Committee
July 7, 1987

My name is Dr. Robert D. Tollison. I am a Professor of Economics at George Mason University. In the first term of the current Administration, I served as Director of the Bureau of Economics of the Federal Trade Commission. Over the course of my career as an economist, I have written about two hundred research papers in academic journals, and written or edited over a dozen books. In recent years, I have devoted much attention to the economics of social cost, an area in which I have written and published numerous articles, as well as a major study entitled Smoking and Society (Lexington Books, 1986).

My testimony concerns possible revenue options; more specifically, I would like to speak to proposed increases in tobacco excise taxes. The discussion of these issues by witnesses testifying previously before the Committee has closely followed the usual lines. Unfortunately, this is to say that it has been very confused and rife with basic economic errors, made worse by the cloaking of these mistakes in impressive sounding technical jargon. But a bad argument remains bad no matter how you dress it up. I will outline these mistakes in turn.

At base, all of the discussion about the supposed need for increased rates of tobacco tax assumes that smokers create large costs for others in society, and ought to be made to pay for these costs. This argument is often made in relation to health care costs. Smokers who get sick require medical care. Therefore, we can supposedly find the social cost smoking causes to society by multiplying the number of smokers times the average medical bill per smoker. The numbers bandied about after this calculation usually seem staggeringly high. One witness, who appeared before this Committee on July 9, 1987, claimed smoking-related health-care costs of $22 billion a year. But these impressive numbers are meaningless, aside from the fact that they are usually wild guesses, snatched from thin air. The medical bills of smokers will normally be paid by those same smokers. The health risk from smoking is well publicized, and those who choose to smoke anyway have decided that the pleasure they get from smoking is worth the price they expect to pay -- that is, the purchase price of cigarettes plus any supposed risk to the individual's health. The same is true with other ordinary risky activities like flying, driving, skiing, and overeating. All of these things land people in the hospital sometimes too. But the individuals involved bear those costs -- nobody talks about the "social cost of skiing."

These "social costs" of smoking are a myth. Smokers pay their own way; they bear the cost of their behavior. Impressive sounding economic jargon is no substitute for economics.

The concept of "user costs" in relation to activities like smoking and the description of excise taxes on tobacco as "user fees" are confused for similar reasons. Calling an excise tax on tobacco a "user fee" is rather like describing a retreat as an "advance to the rear." An excise tax is not a "user fee"-- it is a tax, pure and simple. A real user fee can serve to efficiently ration a scarce resource which the government owns, and fill the same role as a market price. For this reason, many economists think that replacing taxes with user fees where feasible is likely to improve efficiency. But a real user fee is a price paid by an individual demander of some government service. Examples of user fees are a homeowner's water bill, a toll to cross a bridge or a charge to enter a national park. The problem with describing an excise tax as a user fee is that, because there is no way to "unbundle" the supposed service tied to the sale of the good, we can't tell whether or not the consumer would actually freely choose to pay for it if given the opportunity. What government "service" does the martini drinker receive in exchange for the federal tax he pays on his bottle of gin? In the case of tobacco, no one claims that every smoker gets sick from smoking. So excise taxes on cigarettes force healthy smokers to pay for "services" they never receive; as far as sick smokers go, they are forced to pay the tax over and above the cost of their health care (which they will normally pay for themselves). This is even granting the proponents of this idea the benefit of the doubt that modern medicine can determine exactly what portion of health-care costs are the direct result of smoking-induced problems. But, of course, not even the most ardent opponent of smoking would claim this. So we are left with a supposed "user fee" which is designed to charge the smoker for the cost of his or her smoking-related health care -- only we have no way of determining what this cost is, as distinguished from the total cost of health care. In sum, the entire idea of claiming tobacco excise taxes as "user fees" is a grotesque parody of economic reasoning. Once again, this quasi-economic reasoning is potentially open to abuse by those who advocate higher excise taxes for other reasons.

Pretend that cigarette taxes are "user fees" for health care -- that is, ignore the problems with social cost and the misapplication of the "user fee" idea to tobacco consumption. Many smokers, like other people, get sick at one time or another, and require costly health care. Many consumers of other goods get sick too. The obvious question, then, is why stop at tobacco? Obvious candidates for such additional user fees are driving (perhaps a health user-fee component of the gasoline tax?), swimming, running, and cholesterol consumption. Although I have not researched the issue, I would venture a guess that fried food causes more health-care related costs than cigarettes. A "fried chicken user fee" tax would make as much sense as the cigarette tax as a "user fee." In terms of logic and in terms of economics a "fried chicken user fee" and "cigarette user fee" are very similar. Another way of putting the matter is that the misapplication of the term "user fee" to excise taxes borders on the ridiculous. Word games do not contribute to sensible debate over tax policy.

On similar grounds, heart-wrenching claims of large numbers of death supposedly resulting from smoking represent cheap attempts to manipulate emotions in place of providing reasoned argument. The high figures for smoking caused deaths offered by some opponents of tobacco -- 100,000, 200,000, even 350,000 a year -- are only arbitrary estimates. No sensible person denies that smoking involves risks. But all activities involve some risk. To return to the previous example, consumption of fried foods increases the risk of death from heart disease, and possibly, cancer, for millions of people each year. The cost of health care, as well as whatever the number of deaths, induced by smoking needs to be put in perspective. No tax policy can ever eliminate risk from life.

There is an obvious advantage to attempting to pass off a tobacco tax as a "user fee," however unjustified such a description is on economic grounds. Such a description disguises a tax as something else. But a tax is a tax. Increasing excise taxes on tobacco or other products is not going to increase consumers' health, or reduce "social costs," or improve the moral fiber of America. Increasing taxes simply reduces the income of individual taxpayers, and transfers it to purposes favored by the political allocation process. Advocates of excise tax increases should be honest enough to stand up and admit that they want to take more money from one group in society (in this case, smokers) and give it to other groups or purposes. In short, rather than a "user fee," excise taxes are actually income transfers by government. My analysis of excise taxes shows me that reliance on such revenue-raising devices is both inefficient and inequitable: inefficient because excises are capable of generating only marginal contributions to the total revenue of the Federal government, and inequitable because numerous studies have demonstrated that excise taxes in general, and tobacco excises in particular, tend to have a highly regressive effect. Excise taxes are taxes on poor people. But these considerations aside, excise taxes are revenue-raising devices, not "user fees" or anything else. There are enough real issues involved with Federal tax policy that we don't have to waste time on phony issues.

The final point involves not economics but simply political philosophy. Put simply, where does paternalism begin and end? If the Federal government should protect smokers from their own individual choices through the tax code, should it also "protect" other consumers from their own choices involving other goods? Logic would require advocates of increased cigarette taxes to answer this question in the affirmative. Common sense dictates a different answer. In a free society, government must refrain from treating its citizens like children, and should use its tax code to raise revenue rather than attempt to engineer society.

In sum, the social costs of smoking are a myth, pure and simple. Generally, smokers are aware of the risks of smoking, and pay the costs of their smoking behavior. The costs of smoking are private costs, paid by smokers, not social costs paid by others. Indeed, in the area of health-care costs alone, it might even be that smokers over their lifetime place fewer demands on social health care resources than do nonsmokers, making it very likely that an increased excise tax to charge smokers for their alleged "over use" of such resources is simply a punitive measure designed to take away the wealth of low-income smokers.

UNITY BROADCASTING NETWORK, INC.
10 COLUMBUS CIRCLE • NEW YORK, NEW YORK 10019
TELEPHONE NO. 212/586-0610

July 24, 1987

The Honorable Dan Rostenkowski
Chairman House Ways & Means Committee
1102 Longworth House Office Bldg.
Washington, DC 20515

Dear Representative Rostenkowski:

Unity Broadcasting Network would like you to consider its views on proposed legislation that would raise federal excise taxes on a variety of consumer products and services, including cigarettes.

In a recent study by the Congressional Budget Office it was reported that doubling the federal cigarette tax, for example, would cost a poor family four times as much as a wealthy family as a proportion of income. Minorities make up a disproportionate amount of lower-income groups, and both groups make up a disproportionate amount of smokers. What this means is that increases in the excise tax would impact hardest on minority and lower income groups. We feel that excise taxes are discriminatory, unfair and contrary to President Reagan's promise to the American people not to increase taxes under any circumstances.

Unity Broadcasting would like to take these views into consideration when this legislation comes before you.

Sincerely,

Sydney L. Small

Sydney L. Small
Vice Chairman

SLS/dmc

[SIMILAR LETTERS WERE SUBMITTED BY THE FOLLOWING:

NBN BROADCASTING, INC., ADRIANE T. GAINES, VICE PRESIDENT, NEW YORK, N.Y.
WWRL, VINCE SANDERS, VICE PRESIDENT & GENERAL MANAGER, NEW YORK, N.Y.]

NATIONAL BLACK NETWORK—NEW YORK
WDAS-AM/FM—PHILADELPHIA • KATZ AM/WZEN FM—ST. LOUIS • WWRL AM—NEW YORK

TELEPHONE EXCISE TAXES

CTIA™

July 29, 1987

Robert Leonard
Chief Counsel
1111 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Leonard,

During his testimony before the Ways and Means Committee on July 9, the President of Ameritech Mobile Communications, Inc. made three points about cellular telephone service:

1-cellular service is not a luxury, a toy for the rich. It is is a business tool. To back this point up, he noted a March survey showed that 98 percent of the subscribers in Ameritech's five state service area use cellular in a business context. The national average for business use is probably between 85 and 90 percent.

2-business people use cellular service because it increases productivity and thus revenues. The Federal Treasury benefits from increased taxes.

3-cellular telephony, like its cousins in traditional telephony, will bear its share of the burden if the the Committee and the Congress vote to retain the existing three percent excise tax on telephone service. But we can see no justification for the potential increase from three percent to five percent for cellular.

An article in the Los Angeles Times, Car Phones: "From Toy to Valued Tool," sets out that cellular adds $1,000 a month in commissions for a salesperson.

An article in the Dallas Morning News cites a study that showed a $40,000 a year mid-level sales employee was worth $125,000 to his company in salary, fringes, overhead, reimbursed expenses and contribution to profit. Such employees spent 6.7 hours a week on the road. This unproductive driving time cost the company $21,000 a year. Cellular phones made some of that road time productive. How much? According to the study, the $60-$65 a month phone bill was a minor trade off for the increased nine percent productivity.

Cellular Telecommunications Industry Association
1990 M Street, N.W., Suite 610, Washington, D.C. 20036 • (202) 785-0081

The Wall Street Journal's story, "Car Phones Become the Sales Force Fifth Wheel," details a day on the road with a salesperson using a cellular phone and how it increases productivity.

I hope you will have an opportunity to scan these articles. They set out why cellular telephone service is productive and not a luxury for the rich . I hope you will not vote to place a higher excise tax on cellular telephone service than may be placed on other telephone services because of the misconception that cellular is a luxury.

I would be pleased to answer any questions you may have about our young industry and look forward to hearing your comments on this issue.

Robert W. Maher
Bob
President

PS - I know you need more paper!

Business

Sunday, April 19, 1987 ©The Dallas Morning News, 1987

Finding that dialing and driving mix

SCOTT BURNS

Conversion to new technologies, like other leaps of faith, comes in strange ways.

Take cellular phones.

Before last November, I didn't like them. It bothered me that someone with an antenna on his car might run me off the road while seeking operator assistance, dialing his girlfriend or closing yet another big deal.

You should know that I am no neo-Luddite, aching for the return of pastoral life. I have several calculators. I wear a digital watch that not only tells the day, minute and hour but times, counts down and wakes me up. A computer is my primary tool at work, and I own three computers at home. Call me Early Adopter, nerd variety.

But car telephones? That was too much. Until November.

My conversion from viewing cellular phones as ridiculous contraptions to seeing them as sublime instruments occurred between LaGuardia Airport and Manhattan, when I arrived at 2:30 a.m. without a hotel reservation. To make matters worse, there were no cabs.

Then the limo appeared.

Operated by an entrepreneur, he volunteered (for an immodest fee) to take three lost souls into Manhattan. When he learned that I had no place to stay, he said he had a cellular phone and would call ahead. Did I have any preferences?

Forty minutes later I was asleep, a convert to the miracle of cellular phones.

Since then, I have watched a surgeon learn the post-op condition of his patients from his car and heard one of Dallas's top real estate producers swear she couldn't work without one. People who have them feel as passionately about their cellular phones as Elvis felt about his blue suede shoes.

No more hang-ups

To learn more, I interviewed Dan Yost, president and general manager of Metrocel Cellular in Dallas. Yost, 37, came of age in the era after the Carterphone court decision, which opened the door to deregulation and more rapid technological change in communications. He has worked in communications since graduating from Southern Methodist University, worked with 120 clients on filings for cellular markets when the FCC opened the field in 1981, and now runs one of the fastest-growing cellular markets in the nation for Lin Broadcasting, the largest of the non-Bell operating companies in the cellular markets.

Yost said that contrary to the public image of car phone users as Mercedes-driving dealmakers, about 34 percent of cellular phones have been installed in pickup trucks. Another 17 percent of the users are in sales, he said, and 97 percent of use is during peak hours from 7 a.m. to 8 p.m., with 83 percent of the calls for business purposes. As the cost of cellular has come down, he observed, the value of the cars in which phones were installed also has declined. While he has no exact figures, he said he has seen installations where the value of the phone may have exceeded the value of the car.

When I asked about unusual applications of cellular phone technology, he allowed that there were some customers who used their phones at night and paid their bills in cash. I suspect they were not vendors of pizza or Chinese food.

There appear to be three major driving forces behind the growth of cellular phones: critical contact, necessity and economics.

Critical contact is the need to be in touch. While a beeper can let anyone know that they have a call and deliver a brief message, the person beeped must still find a way to return the call. A cellular phone can mean no more blackout periods for the doctor driving between two or three hospitals, contact during a crucial negotiation, and instant information to those who deal in active markets.

If critical contact is vital to some (particularly those with type A predispositions), the cellular phone is a simple necessity to others — such as contractors, some architects and others in the building business. The same can be said for those who do work and gather data in remote areas. A car phone is a lot better than hunting for a 7-Eleven store.

For others the justification is economic. An American Telephone & Telegraph Co. study, for instance, showed that a $40,000-a-year midlevel sales employee was worth about $125,000 a year to his company in salary, fringes, overhead, reimbursed expenses and contribution to profit. The same employees spent 6.7 hours a week "on the road," which meant that their unproductive driving time cost the company $21,000 a year.

Equipping the employees with a cellular phone, the study found, made some of that road time productive and increased sales. How much? An average of 9 percent.

Measured against these benefits and possible gains, a cellular phone bill of $60 to $65 a month (Yost's figure for average use if the heavy users are removed) is minor. Small wonder growth is fast and investor interest is hot. "Some technology has to be taught," Yost said. "Cellular isn't that way. Most people know how to use a phone. Now that it is available, there is a ready market."

Which makes you wonder: Can you invest in the technology without buying a phone?

The answer is a qualified and cautious, "Yes."

As you can see in the accompanying chart, eight of the top 10 companies (which account for almost 90 percent of all cellular subscribers) are owned by Bell regional operating companies. Metromedia has been selling its cellular interests. Which leaves one company, Lin Broadcasting. Although the company is restructuring to pursue cellular very aggressively, Lin is far from a "pure play" in cellular since the bulk of its revenues (and all of its profits) come from television and radio broadcasting.

What to do?

Be philosophical. Know well that the cellular phone, in addition to finding scarce hotel rooms in the middle of the night, brings us yet another step closer to what historian Oswald Spengler said is the goal of Western civilization — the transcendence of space and time.

Car Phones Become the Sales Force's Fifth Wheel

THE WALL STREET JOURNAL MONDAY, JULY 27, 1987

Manager's Journal

By Jack Falvey

In preparation for the keynote speech at the B.F. Gordrich Elastomers and Latex Division's National Sales Meeting, I spent a field day with Mike Rowland, their New England sales rep. As we drove away from our hotel rendezvous he pressed a pre-programmed" button on his cellular phone that automatically dialed an 800 number in Cleveland. His territory customer-service rep answered and told Mike that there were no messages. Sort of an expensive gimmick, I thought. But then the action began.

Mike asked for the shipping status of an order for his first call and also asked the customer-service rep to call ahead for him and confirm our 9 a.m. appointment. Next, he asked if an appointment could be made for the following Thursday in a distant city and if so, could he get a hotel reservation there as well. He said he would check back in 15 minutes. The cheerful voice in Cleveland said "Talk to you later," and a field day like no other I had ever experienced began.

A second pre-programmed button was pushed and a lab technician at another plant location answered. "Was the sample of the material that an account wanted to return for credit defective?" Not according to the tests, but it might be a good idea to take it back anyway because the application was not the best possible. "Okay, let's see how it goes."

About then it was time to check back with the customer-service rep. The first account was expecting us, the last order had been delivered late the previous afternoon and the following week's appointment hadn't been set up yet. We pulled into the first stop of the day. We were ushered into a conference room where coffee and three engineers all arrived as we walked through the door. While Mike knew that company's last order had arrived late the previous afternoon, the customers hadn't realized it was in yet. They were impressed that we were right on top of things. A conventional sales call took place and soon we were back on the road and on the air again.

Mike called in a new order. The account would send confirming paper work. A request to mail some specifications was fielded by the customer-service rep at the same time and a message was passed back to Mike to call the vice president of sales on an expense-account item. He decided not to return that call at once—well, not everything had changed since the old days. The whole process of the call-ahead confirmation for the next account was then repeated.

We stopped at the side of the road for about two minutes to make luncheon reservations for our noon clients. Mike explained that he didn't have the number pre-programmed, and that it was safer to stop the car to look up the number in his book and then dial it. By the middle of the afternoon he had trained me to make these kinds of calls. Twice during the day his all-present, all-knowing, hard-working support person in Cleveland was busy when he called. He left a message on the voice hold-and-forward system.

By this time I was checking my calendar to see what century we were in. How could so much change with just the addition of a car phone? It seemed as revolutionary as when the Model T Ford put salesmen on the road, allowing them to go to their customers rather than lugging their sample trunks from a train station to the local hotel so potential buyers could visit them.

Why should a field sales rep have to write a call report if someone sitting in the home office in front of a computer terminal could enter the data firsthand? Why should a highly paid field sales representative enter orders or follow up on delivery when someone paid one-third as much, and supporting three or four field sales people, can do it faster and far more effectively? The combination of cellular phone technology, a customer support person with a main-frame terminal and a field sales rep makes this technology cost effective for the first time.

There is no need to force the future upon your organization. According to Lynn Rose of the Cellular Telecommunications Industry Association, a trade group based in Washington, there are 200-plus Cellular Systems now in operation serving 124 metropolitan districts in the U.S. The FCC has selected operators for 305 more for future licensing with an additional 300 rural areas to follow. You could phase into cellular phones by equipping your most productive sales reps as a pilot program.

Lest you worry about being too innovative, Del Lippert of Novatel Ltd., in Alberta, Canada, who is involved in the production and sale of cellular equipment internationally, says that the Scandinavian countries and the U.K. are far ahead of the U.S. in cellular applications. He predicts costs will come down, but that at least by the year 2000, phone numbers will be assigned to people as well as places, so that you will have the option of taking your number with you wherever you go.

But back to the here and now. Getting the comptroller to go along with cellular phones for sales reps—whom they already view as extravagant cost creators—is as big a management challenge as any you might face. Think for a moment about the response the brave vice president of sales who first recommended buying company cars for his sales force probably elicited: "Automobiles are toys for the idle rich. What's wrong with the railroad? Why should salesmen go out and find new customers? Don't we have enough to keep the factory running now?"

It was overcoming that kind of thinking that helped shift our economy from a manufacturing base to a marketing base shortly after 1900. Instead of having to sell what the factory could make, the factory had to expand to make what the sales force could sell.

Getting your sales reps in front of customers and keeping them there for five days a week instead of four definitely will improve sales. They don't belong behind desks or computer terminals. Remind the comptroller that before he can create a bottom line, someone must generate the top line of the income statement. By having the sales representative do what he or she does best—namely, meeting directly with the customer—and by supporting that function with skilled people to do the automated administration for them via cellular phone connections, you can change the way your top line is created.

Los Angeles Times

Tuesday, July 7, 1987

Drive and Deal

Car Phones: From Toy to Valued Tool

By J. MICHAEL KENNEDY,
Times Staff Writer

HOUSTON—Time was, rancher J. W. Golla would have to go after poachers himself because it would take so long for the law to get there.

Being out in the country and all, he'd have to drive maybe 20 miles just to get to a phone and, more likely than not, the poachers would be gone before the deputies or the game warden arrived.

Golla doesn't go after the poachers by himself any more. Instead, he reaches for the cellular phone in his pickup truck, dials the Sheriff's Department and waits for someone to show up.

"They're great," said Golla. "My wife told me the other day, 'I don't know what you'd do without that thing.' "

Not that Golla uses his cellular telephone just to collar crooks. When the motor on one of his wells broke down not long ago, he called a mechanic on the spot. After loading cows into the trailer, he calls the auction barn to tell them he is on the way. And Golla handles business calls from prospective duck and deer hunters as he drives about the 6,000 acres that he owns or leases.

So much for the image of the cellular phone as a rich man's toy.

Middle-Class Market

The cellular telephone, once confined to luxury cars and limousines, is rapidly becoming a tool of the middle class throughout the country. In January, 1986, there were 91,600 cellular telephone subscribers in the United States, most of them in major markets such as Los Angeles and New York. By the end of 1987, industry analysts predict, there will be more than 1 million in 120 cities nationwide.

"We're barely into the consumer market," said Robert Maher, executive director of the Cellular Telecommunications Industry Assn. "The technology is there to make this the ultimate personal communications system."

The cost of a cellular telephone is dwindling rapidly, making it affordable for more and more people. A few years ago, such phones sold for $3,000 and up; now, one can be purchased in many markets for as little as $700.

'Cell' Is Geographic

The cellular telephone derives its name from the way geographical areas are divided into "cells" that range in size from two to 20 miles in diameter. Calls go to the cell switching system, which connects to the regular telephone service. Callers can move automatically from cell to cell as they drive through a city. While older car radio-phones could accommodate as few as 12 calls at a time, cellular systems can have as many as 100,000 subscribers.

Once it was a rare occasion to see someone driving down the road with a telephone at his ear; now it is a commonplace event. "People used to just stare, but now it's no big deal," said Betty Melton, a Houston real estate agent who is constantly using her cellular phone to make house-showing appointments. Sixteen of the 23 people in her office use them.

Houston mortgage loan officer Clay Brewer recently was talking on his car phone while stopped at a red light. He looked to his right and saw another man doing the same thing. Then, in his rear-view mirror, he saw that the driver behind him was also on the phone.

"It's the most effective tool I have in my business," he said in a telephone interview from his car. "It picks me up an additional $1,000 a month in commissions. It more than pays for itself."

While the majority of cellular telephone subscribers are people in sales or owners of small businesses, those are not their only users.

The steps of the New York state Supreme Court building in Manhattan looked like a cellular phone convention earlier this month, as the verdict was reached in the case of Bernhard H. Goetz, who gained national attention when he shot four youths on a New York subway in 1984. Where once news reporters would fight for a pay telephone, radio and television reporters carrying the Goetz trial reached into their briefcases for cellular phones to call their stations.

At a recent charity golf tournament in Wilmington, Del., score-keepers called in their tallies at each hole with cellular phones.

During court hearings in Houston that pitted oil giants Texaco and Pennzoil against each other in late 1985, stockbrokers routinely used cellular phones to relay the latest developments to their home offices. Chicago lawyers used the phones in open court last winter to field calls during a primary election dispute. Lobbyists in Austin walk the halls of the state Capitol, setting up appointments on their portable, wireless telephones.

Most of the squad cars of the St. Petersburg, Fla., police department are equipped with their own phones, as well as portable computers for filing reports. The cars of the Yolo County Sheriff's Department in Northern California all have cellular phones, and Lt. Jerry Shellinger said they have changed the way officers go about their duties.

"It's the difference between day and night," said Shellinger, whose deputies have been using the phones since March 1. "It's revolutionized our work habits and schedules."

He said that deputies can now call in and dictate their reports instead of driving to the office. They can be on the telephone immediately to people in trouble,

CELLULAR: Phones Evolve From Toy to Tool

telling them what to do until help arrives. Shedinger said it gives those on the other end of the line a sense of immediate response and that, in several cases, deputies have learned enough over the phone to spot and arrest a fleeing criminal.

"People are satisfied," he said. "It's a public relations tool."

In Cleveland, Cuyahoga Community College uses a 23-foot Winnebago van equipped with cellular telephones to register students for the coming semester. The van goes from fairs to shopping malls, where prospective students sign up for courses via a computer that sends information back to campus via the wireless phones.

While the cellular phone has made great strides since it was introduced in Chicago in 1983, there are some drawbacks and problems, as well as misuse.

Art Brodsky of Communications Daily, an industry trade publication, said that while the cost of doing business over the cellular telephone has gone down, it is still not uncommon for a monthly bill to be $300. One reason for that, Brodsky said, is that cellular subscribers must pay not only for calls they make, but also for calls they receive.

"It's still going to be a business device, primarily, until the cost of the equipment and time go down," he said.

The Federal Communications Commission has allotted two cellular systems to each market, and Brodsky said that several large population centers are approaching capacity. Meanwhile, cellular users can not just pick up the phone anywhere and dial their homes or offices. Most rural areas are out of range of the cells that pick up car telephone signals, and subscribers in some places can drive for hours before they may dial again. Brad Miles, a spokesman for Telecator Network of America, said that 423 "rural service areas" are only now beginning to be licensed.

As for misuse, there is the question of eavesdropping, using scanners that pick up cellular calls. So great was the concern in California that the Legislature two years ago passed a law making it a crime to intercept cellular telephone calls maliciously, and banned devices manufactured solely to monitor such calls. Congress last year passed legislation with even tougher wording, making it a felony to eavesdrop intentionally on cellular conversations.

More recently, the California Public Utilities Commission ordered cellular phone companies to include with its bills a warning to subscribers that their conversations may not be private. Cellular phones in California will also have to carry labels advising callers to tell the party on the other end that the call is from a cellular phone and there is no guarantee of privacy.

Bid-Rigging Alleged

There also have been some allegations that lotteries used to decide who will get the license to operate a cellular system have been rigged to favor particular groups around the country.

Perhaps the greatest fear expressed about the use of car phones concerns safety, and the question of whether a driver using one is paying less attention to the road.

A controversial study, released in 1985 by AT&T, Bell Atlantic Mobile Systems and the American Automobile Assn., found just the opposite. The report said that drivers with car telephones spend twice the average time on the road, but are only half as likely to be involved in an accident.

That idea seems to be backed up by another study recently completed by the California Highway Patrol, which, on balance, gave the cellular phone high marks.

"Generally speaking, we found that cellular phones are safe," said CHP spokeswoman Susan Cowan-Scott. They also found, she said, that over an 18-month period, the number of 911 emergency calls made from cellular phones increased 700%. She said that most of those callers were reporting highway accidents and drunk drivers.

"They have definitely increased the eyes and ears of the highway patrol," she said.

Cowan-Scott said that, in fact, cellular phones might be a deterrent to reckless driving, because people can call ahead if they are running late in heavy traffic. And Dancie Perugini Ware, who runs a Houston public relations firm, said there is great security in having a telephone within reach as she drives the city's highways.

"It gives me a good feeling of security," she said. "When I'm on the road, 99.9% of the time I'm alone and I'm out at night a lot. It's a real safety factor. I can let my family know when I'm going to be late and I can get help if there's car trouble."

Cellular phones of the future will probably be smaller and better. Maher said that wireless phones roughly the size of a checkbook are already being developed.

One certainty, though, is that the cellular telephone is not a passing fad for the rich. Said Melton, the Houston realtor: "You just can't do without them once you've got one."

58 The Toronto Sun, Wednesday May 27, 1987

EMERGENCY USE GROWING

Cellular phones to the rescue

By LEE LESTER
Business Writer

The wife of CBS Records v-p Jeff Burns lay hemorrhaging in his car in a Don Valley Parkway traffic jam.

The car had come to a stop on the shoulder, halted by other drivers pulling over in front of him to stop him overtaking them in the stalled lanes of traffic.

Not even his flashing lights and frantic sounding of the horn could move the resentful other drivers.

Desperately, as the seconds ticked away, Burns dialled 911 on his cellular phone and was connected to the ambulance service.

"Keep your wife still," he was told before being transferred to the police.

Within minutes two cruisers arrived. With one in front and the other behind, the convoy, with lights flashing, sped off as the shoulder cleared.

BABY JUSTIN, mom Ann and dad Jeff Burns are all doing well, with a little help from their cellular phone.

Burns made one more call to tell the hospital to be ready for his wife's arrival.

Five minutes after reaching the hospital, his wife had a Caesarian section and delivered a two-months premature son who was promptly placed on a respirator.

That was four months ago and the baby, named Justin, was allowed home only last week.

The incident highlights the growing use of cellphones not just as an expensive electronic toy or business aid, but in emergency situations.

Said Burns: "I had only had it a month. It was a luxury item and I kept asking myself, 'Do I really need this for business?'

"But it turned out to be the best investment I have ever made. Without it, we would certainly have lost the baby and I probably would have lost my wife too."

In Vancouver, salesman Jerry Grootveld said: "As I walked out of my bank I noticed a suspicious man leave with a bank employee in pursuit.

"I followed in my car and called 911 and was connected with the police. I tailed the suspect for a few blocks until the police nabbed him."

And, in California, the Highway Patrol says cellphones are used more than 250 times a day for emergency calls.

Most are used for accident reports followed, in order, by traffic hazards, fires, reckless driving, drunken driving, hit-and-run accidents and crimes in progress.

In Toronto, Cantel assistant manager Paul Preston said: "Customers are using the free 911 service to report accidents as well as crimes. Cellular phones are proving an invaluable emergency aid to summon help quickly.

"Cantel cellular subscribers make more than 1,500 calls monthly to the 911 emergency number."

And Metro 911 co-ordinator Tom Voicy said: "All motorists are a little safer because of the existence of so many cellular mobile phones."

To encourage use of the emergency number, Cantel urges its customers: "Be a cellular Samaritan." The customers, it says, can be the eyes and ears of the police, fire department and other emergency organizations.

Meanwhile, happy daddy Jeff Burns urges other drivers: "Give way when someone drives along the shoulder. He may not be a smart ass; it could be a genuine emergency."

HERSCHELSHOSTECKASSOCIATES

SURVEY RESEARCH AND CONSULTING
COMMUNICATIONS
PUBLIC POLICY
MARKETING

WASHINGTON, D.C. OFFICE
10 POST OFFICE ROAD
SILVER SPRING, MARYLAND 20910-1192
301 585-2269

July 15, 1987

The Honorable Dan Rostenkowski
Chairman, Committee on Ways & Means
United States House of Representatives
Longworth HOB, Room 1102
Washington, DC 20515

Dear Mr. Rostenkowski:

I am a telecommunications economist. As such, I have been sent a copy of the recent testimony before your committee of Mr. Richard C. Notebaert, President of Ameritech Mobile Communications, Inc.

Mr. Notebaert testified that an increase in the excise tax on cellular telephone bills would constrain the growth of the industry. From a theoretical perspective, Mr. Notebaert's position is not incorrect nor are his observations invalid.

However, in my opinion, there is a more important issue of reasonably balancing the national budget. Should we not have the will to do so, within three to five years we will pay a substantial economic price.

In light of this, in reaching your decision on tax alternatives, I urge you to pay greater attention to the long term national good, rather than the short terms interests of my own industry.

I do not suggest that cellular telephony be singled out for special taxation. However, if a tax on telecommunication services is necessary for raising revenue, then I believe that cellular telephony should pay its fair share.

Sincerely yours,

HERSCHEL SHOSTECK ASSOCIATES, LTD.

Herschel Shosteck, Ph.D.

HS/s

TELOCATOR® NETWORK OF AMERICA
COMMUNICATIONS ON THE MOVE

STATEMENT OF THE CELLULAR DIVISION OF
TELOCATOR NETWORK OF AMERICA

to the

HOUSE COMMITTEE ON WAYS AND MEANS

regarding the

PROPOSAL TO INCREASE THE EXCISE TAX ON CELLULAR TELEPHONE CALLS
July 15, 1987

The Cellular Division of Telocator Network of America ("Telocator"), the national trade association of the mobile communications industry, appreciates this opportunity to present testimony to the Ways and Means Committee regarding the proposal to increase telephone excise taxes. Telocator represents licensees of cellular and conventional mobile telephone and paging systems.

Cellular telecommunications is an advanced form of mobile telephone service. Cellular telephone systems divide a market into a honeycomb of zones or "cells," each of which utilizes the same frequencies. As a caller moves from one cell to another, a sophisticated computer-based switch "hands off" the call to an available frequency without any interruption. Cellular technology enables many callers to use the same frequency simultaneously. This capability of "frequency re-use" in a single market enables cellular systems to provide service to tens of thousands of customers in any given market. By comparison, conventional mobile telephone technology can serve only about 1,000 subscribers in a particular market.

The Committee has proposed to increase the telephone excise tax to 5% for cellular and other mobile telephone services. Telocator opposes this proposal. While our comments specifically address cellular, they apply to conventional mobile as well.

Imposing a higher tax on cellular is undesirable for several reasons. First, a higher tax on cellular would reduce its effect as a productivity enhancing tool, which spurs local and national economies. Second, it would disproportionately penalize small businesses, who are the major users and beneficiaries of cellular service. Third, the proposal would deliver a setback to a growing industry that has just recently overcome the effects of years of regulatory delays by the Federal Communications Commission. Fourth, the additional revenue generated by the discriminatory differential would be minimal and would not offset the costs of imposing such a tax.

I. Increasing Cellular Tax Rates Would Inhibit Cellular's Catalytic Effect on the Economy and Adversely Impact the Small Businesses That Are Cellular's Prime Beneficiaries

Beneath the proposal to raise the cellular tax, there may be a perception that such an increase would merely amount to a luxury tax on a plaything of the wealthy. This perception is incorrect. Marketing studies indicate that cellular is not a toy, but rather a tool for greater productivity. According to a 1985 report, the typical cellular user is a person who works out of his or her car: a traveling salesman, a real estate agent, or the head of a construction company, for example. Having a cellular phone frees such people from conventional constraints, and allows them to accomplish two things at the same time. Instead of waiting around the office for an important call, they can be out in the field attending to other business matters. Instead of stopping at a roadside phone and fumbling for change, they can contact clients as they travel to another business engagement. Clearly this increased flexibility has been a boon to the economy.

Cellular's effect on the economy is doubly beneficial because it primarily helps the small businessperson. According to a 1984 survey conducted by Arthur D. Little, Inc., 70% of those interested in subscribing to cellular service are employees of companies with 10 or fewer employees. Congress should not discourage or prevent the small businessperson from obtaining a tool that might well lead him or her closer to achieving the American dream.

II. An Increased Tax Would Harm an Industry That Has Just Recently Been Given a Chance to Get Started

Although cellular technology was developed in the 1960s, it was not until late 1983 that the first cellular system began operating in a U.S. market. For years the birth of the industry was postponed by FCC vacillation over how to regulate it. While the American cellular industry was kept in a slumber by FCC delay, cellular technology was introduced in Japan, the Middle East and Scandinavia. Now that the American industry has finally gotten a chance to get started, it would be unfair and counterproductive to subject it to a discriminatory tax increase above the increase proposed for other telephone services because such an increase would stunt cellular's continued growth.

As of June 5, 1987, there were a total of 202 cellular systems operating in 129 markets throughout the United States, according to statistics compiled by the FCC. In almost all of the markets with cellular systems, there is one system operated by the local telephone company . Many of the markets also have one independent system. As an indication of the industry's youth and potential, the same FCC statistics reveal that there are currently more cellular systems under construction (225) than there are in operation (202). There are also a large number (183) of potential systems in the midst of the license application process.

It would be unfair for Congress to penalize the cellular industry just as the industry is beginning to show its true potential. A tax increase would hurt the industry in several ways. First, the increased cost to the consumer would reduce usage by existing customers, deter potential customers from subscribing, and ultimately impede the establishment of cellular systems in new markets. Second, there has been a dramatic drop in subscriber costs for cellular service in the past few years. The Committee's proposal would reverse this salutary trend, reducing access to this important new technology. Finally, establishing a two-tiered tax would ordain cellular as a second-class citizen, disfavored in the eyes of Congress, and would create a negative perception in the investment community.

Differential tax treatment makes no sense considering that the Treasury already draws substantially more revenue from a given amount of time of cellular service than it does from the same duration of standard telephone usage. Even though cellular costs have plummeted, cellular is still much more expensive than standard telephone. Thus, 3% of a given amount of time of cellular usage generates much more revenue than does

3% of the same amount of standard telephone usage. If anything, then, Congress should consider lowering the tax for cellular as compared to standard telephone.

III. A Higher Tax on Cellular Would Produce Little Added Revenue

Despite its negative, discriminatory effects, a higher excise tax on cellular would produce little added revenue for the Treasury. As a result, there is no reason for the public to absorb these untoward effects. According to projections by the staff of the Joint Committee on Taxation, as reported to this Committee, a three-year renewal of the 3% excise tax would generate a total of $6.0 billion in fiscal years 1988 through 1990. On the other hand, maintaining the 3% tax but increasing the cellular tax to 5% would bring in less than $100 million more, for a total of $6.1 billion in the same three-year period. This represents a mere 1.7% increase in telephone tax revenues and would contribute insignificantly toward reducing the federal deficit.

Conclusion

Raising the tax on cellular telephone service would have several deleterious, undesirable effects. It would jeopardize the growth of a young industry, it would harm the small businessperson, and it would adversely impact the economy -- with only a minor, insignificant benefit to the Treasury. Congress would be well advised to consider other, more effective methods of enhancing revenues.

2579a

OPPOSITION

of the

UTILITIES TELECOMMUNICATIONS COUNCIL

on

"Description of Possible Options
to increase Revenues Prepared
for the Committee on Ways and
Means"

Prepared by the
Joint Committee on Taxation

August 26, 1987

On behalf of the 2,000 electric, gas, water and steam utilities ("Utilities") we represent, the Utilities Telecommunications Council ("UTC") urges that the House Committee on Ways and Means reject the proposed modifications to the federal telephone excise tax (26 U.S.C. §§ 4251-4254) set forth in "Description of Possible Options to Increase Revenues Prepared For the Committee on Ways and Means". Specifically, the Committee should reject the proposal to: (1) repeal the present exemptions from the 3% telephone tax (which includes an exemption for private communications systems); and (2) impose a 10% excise tax on all telephone equipment (including fiber optic links) and communications satellites sold to persons for use in a manner not subject to the telephone excise tax (e.g., private communications systems). Inasmuch as the utilities represented by UTC operate and rely on private communications systems in many phases of their operations, the adoption of these proposals could have a devastating economic impact, so much so that they might be forced to abandon the use of private systems. This could detrimentally affect the ability of utilities to provide safe, prompt, and reliable utility service to consumers.

The privately-owned communications systems operated by UTC members are used for unique data traffic such as protecting the nation's interconnected electric grid (protective relaying) and special control and telemetering of critical natural gas and water pressures. They are also used for critical voice traffic between "power pool" control centers and power plants, and control centers of other "power pools" on the interconnected electric grid.

Utilities operate these systems because they must operate communication systems under their complete control and because they cannot obtain from the telephone companies the quality and reliability of service they need to protect and control the utilities' facilities which deliver service to the public. In order to carry out the task with which they have been charged, namely that of providing utility services to the American public on a continuous basis, 24 hours a day, seven days a week, utilities must have extremely reliable telecommunications which are always under their absolute control, particularly in emergency situations.

Congress has previously noted the importance of these private systems to utilities. In exempting Utilities and other "right-of-way" companies from the bypass charges proposed in H.R. 4102, Congress noted:

> Communications systems included in this exemption are those employed by 'right-of-way' companies and their affiliates (such [as] electric, gas and water utilities, natural gas and petroleum pipeline companies, and railroads) for internal communications needs.
>
> These systems were constructed because sufficiently reliable communications facilities necessary to assure safe, efficient operation of railroads, pipelines, and utilities along their rights-of-way are unavailable from exchange carriers. Such systems have become essential for such functions as the control and metering of

> the flow of oil and natural gas; the safe operation of the railroads; and protective relaying within interconnected electric power grids.

H.R. Rep. No. 479, 98th Cong., 1st Sess. (1983).

Without the ability to operate private systems, Utilities would not be able to provide safe and reliable energy services. Utility service to the American public would be subject to serious disruptions (such as occurred in the 1965 Northeast blackout) and restoration of interrupted utility service would be hindered. Disruptions in utility service can seriously effect the safety of life and property and impair the public welfare.

Following the 1965 Northeast Blackout, the then Federal Power Commission had a study conducted which was published in June of 1967 and entitled, "Prevention of Power Failures." That study stated that the need to assure a high level of reliability in communication, as well as to transmit a growing volume of data, argues increasingly for the use of private microwave with continuously available standby or auxiliary power supply at all communications relay and terminal points, That study went on to recommend that alternative microwave routes for critical communications channels should be provided. As an emergency backup for some communications function "space," radio facilities should be provided.

Most importantly, however, the study states, at page 23, that:

> All critical communications facilities, particularly those having to do with relaying and control of important [electric] circuits and other system elements, should be the responsiblity of the operating utility and under its complete control. [Emphasis added].

As a result, utilities have built extensive private microwave systems. To impose a tax on such systems, would deter their construction and be contrary to the public interest goal of encouraging the use of private systems to provide reliable communications for utility operations.

In sum, the private systems operated by utilities provide a level of reliable, dedicated communications capabilities not available from the local exchange. They are not constructed merely to avoid charges from the local telephone company, or to avoid taxes. Accordingly, the proposed 10% bypass tax should not be imposed on operators of private systems, particularly utilities, whose use of these systems is essential to the nation's welfare. Moreover, because of the critical role private systems play in ensuring continuous utility service to the public, these systems should remain exempt from the 3% telephone excise tax. Accordingly, we urge, the Committee to reject the proposed modifications to the telephone excise tax.

We appreciate the opportunity to express our views on this important matter and are prepared to assist the Committee by providing additional information or answering any questions. In this regard please feel free to contact Shirley S. Fujimoto of Keller and Heckman at (202) 956-5600, or Nina Binstein at (202) 956-5647.

LUXURY EXCISE TAXES - BOATS

ACCESS MULTIHULLS, INC.
5474 Shilshole Avenue, N.W.
Seattle, WA USA 98107-4022
(206) 784-4014

Dear Chairman Rostenkowski,

In regards to the proposed luxury tax on all pleasure boats valued over $15,000 we wish you to consider the following thoughts. It's not included in the Bill of Rights but owning a boat should be a right in a free society without government interference.

No other mode of transportation is taxed more than a boat. Already, boaters must pay an excise tax, county tax, and a state tax. Now, we are looking at an additional Federal luxury tax. Boaters will need a larger boat just to carry all the required stickers and licenses.

From history, we see that a large fleet of pleasure boats has kept a country strong. In 1940, Great Britain evacuated its army from the beaches of Dunkirk using an assorted group of pleasure boats because there was no faster means to get the troops out. Also today, we see that Iran is prepared to use its fleet of 54 foot patrol boats in attacks on our Naval ships which will be escorting Kuwaiti tankers. These boats are little more than modified speed boats. Therefore, one sees that in desperation a country will use whatever equipment is available in times of war. Thus, by making it prohibitively expensive for the public to buy large boats, our government is unknowingly threatening our security.

Also, pleasure boats have assisted in rescues since if there are a large number of them, the statistical probability that one will be in the vicinity of a marine disaster is higher.

Boating is a family activity. Limiting people to small boats will cause great safety problems since boaters will very likely overload their boats by carrying too many passengers.

Consequently, because of the above reasons please reconsider not adding a luxury tax on boats valued over $15,000. They are essential to a free society.

We would appreciate a copy of your comments and actions in reducing this threat to pleasure boating.

Ed Hajek

Sincerely yours,
Ed Hajek

AMAR
ALUMINUM MARINE CONSTRUCTION 120 EAST 23rd TACOMA, WA 98402-2999 (206) 572-2877

August 13, 1987

Rep. Dan Rostenkowski, Chairman
Ways & Means Committee
1102 Longworth House Office Bldg.
Washington DC 20515

Dear Mr. Rostenkowski:

As a manufacturer of aluminum boats in the Pacific Northwest, we are extremely concerned with the proposal to levy a luxury or excise tax on boats costing over $15,000.

Inflation has pushed the price of an average family style boat, basically equipped, to this figure and beyond. If this penalty tax was brought in we can predict that some ingenious manufacturers would cheapen the quality and safety aspects of their craft to produce a package under the limit.

As you know, Washington State has taken over safety on our waters from the U.S. Coast Guard. We don't imagine the State needs any more problems in this area.

About four years ago New Zealand initiated a penalty tax on all marine products and this had a devastating effect on their local marine industry and exports. Thousands of workers were laid off as sales slumped. Volume decreased and so per unit prices were drastically increased. At the time we were using a New Zealand made propulsion system and that item increased in price to the extent, certain of our boats using that product were overpriced in this market. We in turn found them difficult to sell, and laid off a number of employees locally. All is not what it seems when a simple idea is formulated.

We urge you to vote against this measure. Help preserve jobs and the tax paying marine industry please.

Sincerely,

Mike Sandeman
Vice President

MS:jag

6327 Armar Road
Marysville, Wa 98270

To: Senator Dan Rostenkowski
Chairman, Ways and Means Committee

Dear Sir:

I am compelled to write to you concerning the proposed bill in your Committee. This is the bill proposing a luxury tax on all boats with a value of over fifteen thousand dollars.

Besides the tax being grossly unfair it is a preposterous amount to recommend. It would rule out owning a boat for most boat owners are far from rich.

We have worked and sweated to get and maintain a boat. We pay a yearly tax to our State in the form of a personal property tax plus a considerable initial purchase tax and other carefully added taxes.

We boaters do pay our share and more. This current addition would be grossly unfair, I repeat.

Sincerely,

K. O. Barnes

A Tax Payer.

BAY POINT HARBOUR YACHT SALES
JOHNSON BROTHERS BOAT WORKS
FOOT OF BAY AVENUE • POINT PLEASANT • NEW JERSEY 08742 • AREA CODE 201 892-9000 • 892-2300

8/29/87

DEAR CONGRESSMAN ROSTENKOWSKI:

MY GRANDFATHER WAS IN OUR STATE LEGISLATURE ABOUT 80 YEARS AGO, AND EVEN THOUGH HE WAS A REPUBLICAN, I DO NOT THINK EITHER YOU OR HE WOULD LIKE TO SEE ME HAVE TO GO TO THE POORHOUSE BECAUSE YOU PUT A "LUXURY" TAX ON THE BOATS WE SELL

SINCERELY,

DELTA
MARINE
INDUSTRIES,
INC. 1608 South 96th Street, Seattle, Washington 98108 • (206) 763-2383 Telex 32-8044

July 4, 1987

The Honorable Dan Rostenkowski
Chairman
Ways and Means Committee
1102 Longworth Building
Washington, D.C. 20515

Dear Mr. Chairman:

We are writing to express our concern over recent developments regarding the proposed luxury tax on pleasure boats, and the possible elimination of personal income tax deductions for second homes.

As one of the leading fiberglass boat builders in the United States, Delta Marine Industries is particularly well qualified to offer an informed opinion on the potential effects of legislation targeted at the Marine Industry and the boat buying public.

In recent years U.S. boat builders have recovered a substantial portion of the sales for large new vessel construction that had previously been lost to European and Japaneese yards. This recovery has been the result of several factors; including materials development, advancing technology and a highly motivated workforce. However, the single most important factor responsible for the increase in sales has been the total and actual cost of the vessels, with taxes, licensing and duties comprising a significant portion of this total.

Obviously, if the total cost of building and owning a vessel in the U.S. continues to increase in relation to competing countries, the entire domestic Marine Industry will be adversely effected.

In the case of smaller boats, purchased for recreation on U.S. waters, the total cash expenditure often represents a considerable share of a family's disposable income. The imposition of an added "luxury" tax will prevent these families from buying a boat and utilizing the countless recreational opportunities currently available on American lakes, rivers and coastal areas.

Our nation has a strong maritime heritage backed by our unique ability to build the fastest, strongest and most economical vessels afloat. The famous American clipper ships of the late 1800's traveled the oceans around the world, unarmed and unescorted, establishing commercial trading relationships with many countries that have remained our allies for over one hundred years. This heritage has instilled a level of pride that cannot be measured in dollars. The fascination of the U.S. public with our recent victory in the America's Cup challenge certainly provides evidence that the interest and pride still exist.

In summary, we would like to emphasize that the individuals who are fortunate enough to purchase large, expensive pleasure boats will continue to have them built. Overseas construction, foreign registry, or operation as a charter business will all be used to avoid payment of added "luxury" taxes. It is the smaller boat owner that will be most severely hit by a tax whose aim is to derive additional revenue from what is mistakenly perceived as a rich, affluent boat owning elite.

Sincerely,

John F. O'Brien
Delta Marine Industries, Inc.

GARY A. DOHNER
9200 SUNSET BOULEVARD, SUITE 831
LOS ANGELES, CALIFORNIA 90069
(213) 859-0655

July 22, 1987

The Honorable Dan Rostenkowski
COMMITTEE ON WAYS AND MEANS
1102 Longworth House Office Building
Washington, DC 20515

Dear Representative Rostenkowski,

I understand that you are currently considering a luxury tax on various sized boats. While I am not currently a boat owner, several of my friends are and I will probably become one in the next few years, but even without being an owner, I am very concerned about the idea of placing a luxury tax on various pleasure boats. As an occasional renter of these boats, I am sure that the charge will be passed through me.

I am not just writing because of my own self interest - I do not agree in theory with the idea of the luxury tax in the first place. The size, value, etc. of any activity could potentially be subject to this kind of tax. I do not believe that those of us who have worked so hard and are as productive as we are, should be subject to further taxation after having paid our income taxes when we want to enjoy ourselves by boating.

Some of my friends even have as their homes, sailboats of 50 - 70 feet. At what stage does a tax like this start or end. While balancing the budget is an admirable idea, this method of doing so appears to be very discriminatory and potentially devastating to a small industry already besieged by problems (partially created by the most recent tax reform act).

I urge you to consider reducing your expenditures in various programs, rather than selectively taxing people after they have already paid their income taxes on the income it takes to own and maintain these vessels or other products.

Yours truly,

Gary A. Dohner

GAD/csj

EMA

July 30, 1987

Chairman Dan Rostenkowski
Committee on Ways and Means
1102 Longworth
House of Representatives
Washington, D.C.   20515

Dear Sir:

I am a member of the National Marine Representatives Association based in Annapolis, Maryland. As you are very well aware, the Chesapeake Bay is one of the premier boating areas on the east coast, offering not only a relaxing atmosphere, but also encouraging support of Natural Resource Wildlife Programs to maintain the beautiful surroundings.

Approximately four weeks ago, the House, Ways and Means Committee published a "Staff Options List" of revenue raisers to help alleviate the $19 billion gap between expenditures and expensed revenue of last year's federal budget. Among this list, a 10% "Luxury Tax" on boats costing $15,000 and more, was discussed. The Committee learned that pricing studies have shown the elasticity of the boating industry is a 2 to 1 ratio. Sales go down 2% for every 1% increase in price. Also, a luxury tax on boats costing over $15,000 would account for over 75% of the boats manufactured in the United States.

We are willing to pay our "fair share", such as the imposition of excise taxes on our fuel, (for which we have yet to see 10% of), however, I feel this is going a little too far. The proposed 10% tax could produce a loss of as many as 20,000 jobs nationwide, let alone the countless number of potential sales.

Inasmuch as our Federal Budget Deficit is at a staggering level, the "expense" of your Luxury Tax would far outweigh its revenues.

Sincerely,

Mark Charles Forsman
Eastern Marketing Associates

MCF/jlm

EASTERN MARKETING ASSOCIATES, INC.
P.O. Box 3429 • Annapolis, MD 21403 • (301) 268-0282
Representing Manufacturers of Quality Products

11 August 1987

Dan Rostenkowski, Chairman
Ways & Means Committee
1102 Longworth Bldg
Wash. DC 20515

Re 10% Boat Luxury Tax

My wife and I build our boat ourselves from savings. We planned this a number of years ago and wanted to start in 1982 so we could cruise a little bit when I would reach 55 in 1986

Then the crunch came and our little general contractor firm hit tough times. By the way my wife does the framing right along with me. We are small contractors.

Since, our jobs seemed to evaporate along with some of our dreams, we started building our boat in 1985 (3 years behind schedule) as we had very little work but lot of time. It is now completed. We still have very little work. The last 2 years have been the worst but because of our ages have to go now before we get too old to experience our life long dream.

Our earnings averaged $12,000 a year from 1975 to 1985. Then they dipped below $5,000.-

All we needed $ was $12,000 a year to pay the bills and save a little.

We pay cash for everything, safe up for our needs & wants thereby eliminating interest expenses. We can manage.

Our home is up for sale to pay for part of our coming time.

We hope to build in the future again by doing all the work ourselves as we did in the past. The concrete work, framing, roof drywall, you name it, we do it ourselves. Otherwise we could not afford to live here.

Your 10% luxury tax would wipe our savings in one year. Period - gone. Just like that!

There is no protection for small business people like ourselves so our savings become our unemployment insurance.

There are lot of small propriety like business like ours, paying the bills, keeping the economy going. We don't complain; we cope. We are a silent group and need your co-operation to keep us from

TAX ABUSE

we are not rich just careful in our planning.

NO LUXURY TAX

Frank Eicher
8268 Cowichan Rd
Blaine WA 98230

Flying Dutchman
13406 N.E. 37th Place
Bellevue, Washington 98005-1416
(206) 883-7408

July 17, 1987

Dan Rostenkowski, Chairman
Ways & Means Committee
1102 Longworth House Office Building
Washington, DC 20515

Dear Congressman Rostenkowski:

You are our Congressman so please put yourself in our position. You worked hard and saved for 19 years to buy a business. You paid $150,000 and personally guaranteed another $250,000 from Peoples National Bank. You "own" a respected 12 year old Seattle area boat sales company. You're living the "American Dream." Your boat sales create jobs and income for Americans like your Seattle Naval architects, marine surveyors, project managers, your lawyers, accountants, bankers, dock workers, craftsmen and vendors. Plus your boat sales business pays substantial federal, state and local taxes. So what if the boss is left with maybe $18-24,000 a year after everybody else is paid?

About 1986-87 your government starts pressuring the Republic of China to help reduce America's trade deficit. ROC currency is revalued 25% in a year. Your retail boat prices skyrocket from $60,000 to $75,000! You soon discover that your potential buyers won't accept these shocking increases. You haven't sold a single boat yet in 1987 from your $360,000 inventory!

Now comes the House Ways and Means Committee trying to bail out an overspent Congress. They spot America's so-called rich boat buyers and wealthy dealers. Let's tax the rich bastards 'til they're dry", says the Committee. "Let's put a 10% federal luxury tax on their toys. Those rich boaters and boat dealers won't feel a thing."

Well sir, I will feel your tax lance into the heart of my already wounded business. A federal luxury tax will put me out of the boat business overnight! My buyers are not rich and cannot pay a combined 25% currency increase plus your 10% luxury tax. Just ask yourself, could you afford a $22,500 price increase - that's 37.5% - in the period of a year? Of course not, and my buyers can't either!

The fact is that boaters - and boat dealers - are not rich people. They are usually thrifty Americans who have given up other recreational choices to afford the benefits of family boating. Why now tax boaters out of boating? Why now tax me out of business?

Please don't permit the House Ways and Means Committee to terminate my business and my livelihood with a discriminatory 10% luxury tax.

Sincerely,

Norman L. Wherrett

Norman L. Wherrett
President

HUGHES
Subsidiary of GM Hughes Electronics

ALLEN E. PUCKETT Chairman Emeritus

22 July 1987

The Honorable Dan Rostenkowski
Committee on Ways and Means
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Dan:

We understand that consideration is being given to the establishment of a luxury tax on privately-owned boats used for recreational purposes. It is difficult for me and for millions of other boat owners to understand why we should be singled out for this treatment.

Recreational boating has become a major activity in this country, enjoyed by millions of Americans of modest means, who are interested in fishing, sailing, or simply the pleasure of being on an uncrowded waterway instead of a freeway. The imposition of a burdensome tax would almost certainly reduce participation in boating — with serious negative impact on that industry.

We urge that you strongly oppose any attempt to penalize the participants in this particular recreational activity.

Sincerely,

Allen

ALLEN E. PUCKETT

Corporate Offices: 7200 Hughes Terrace
P.O. Box 45066, Los Angeles, CA 90045-0066
(213) 568-6100

Marine Trades Association of Maryland, Inc.

"Working Together For The Marine Industry"

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Bob Wilson
Mears Point Marina

* *Affiliate*

August 31, 1987

Representative Dan Rostenkowski, Chairman
House Ways & Means Committee
1102 Longworth Building
Washington, DC 20515

Dear Mr. Chairman:

I am writing on behalf of Maryland's recreational boating industry to express our strong opposition to a proposed 10 percent "luxury" tax on all new boats retailing for $15,000 or more. Our industry includes approximately 1,300 businesses which, for the most part, are small family run operations.

To impose such a "luxury" tax on certain boats would have a devastating effect here and across the nation because our industry creates and impacts on many entry level jobs as well as contributes heavily to local economics. Consider, for example, that every $1.00 spent in a marina, $2.50 is spent in the local community; and for every boat in a marina, six jobs in the local community are impacted.

While we are sympathetic to the tremendous challenges ahead for you and your committee members, we emphasize that any proposed legislation which would negatively impact on an industry which has such far reaching implications should be scrutinized very carefully.

Thank you, in advance, for your consideration.

Sincerely,

Mick

Mick Blackistone
Executive Director

cc: AAMTA & MTAM Board of Directors
John Burgreen, Annapolis Yacht Sales

P. O. Box 3148 • Annapolis, Maryland 21403

OMC Calhoun

A Facility of Outboard Marine Corporation

P.O. Box 1419
100 Marine Drive
Calhoun, GA 30701

AUGUST 24, 1987

DAN ROSTENKOWSKI
2111 RAYBURN HOUSE OFFICE BUILDING
WASHINGTON, D.C. 20515-1308

DEAR REPRESENTATIVE ROSTENKOWSKI:

I UNDERSTAND THAT THE WAYS AND MEANS COMMITTEE IS CONSIDERING A NUMBER OF REVENUE-RAISING MEASURES, INCLUDING A 10 PERCENT LUXURY TAX ON BOATS COSTING MORE THAN $15,000. FOR THE REASONS LISTED BELOW, OUTBOARD MARINE CORPORATION STRONGLY URGES YOU TO OPPOSE SUCH A TAX.

BECAUSE OF THE ELASTICITY OF DEMAND FOR OUR PRODUCTS, WHICH HAS BEEN ESTIMATED TO HAVE A FACTOR OF APPROXIMATELY TWO, WE BELIEVE A 10 PERCENT LUXURY TAX ON BOATS WOULD RESULT IN ROUGHLY A 20 PERCENT DROP IN SALES. THE CORRESPONDING LOSS OF INCOME AND PROFITS, COMBINED WITH REDUCED PRODUCTION AND PAYROLLS, WOULD CAUSE A NET LOSS OF REVENUE TO THE GOVERNMENT.

THE PROPOSED TAX ALSO HITS SOME COMPANIES HARDER THAN OTHERS, SINCE PRODUCT LINES VARY WIDELY IN THIS INDUSTRY. A MAJOR GOAL OF THE TAX REFORM OF LAST SESSION WAS TO ELIMINATE THIS KIND OF DISPARATE TREATMENT IN OUR TAX CODE.

PLACING A LUXURY TAX ON ONE SEGMENT OF THE RECREATION INDUSTRY AND NOT OTHERS HAS THE POTENTIAL TO CAUSE CONSUMERS TO SHIFT THEIR DISCRETIONARY PURCHASES FROM BOATING TO OTHER UNTAXED RECREATIONAL AVENUES. WE DO NOT BELIEVE CONGRESS SHOULD USE THE TAX CODE TO PUNISH CERTAIN TYPES OF RECREATION AND REWARD OTHERS.

IN SHORT, THE PROPOSED TAX WOULD BE APPLIED UNEVENLY, RESULT IN A NET LOSS OF REVENUE TO THE GOVERNMENT AND CAUSE CONSUMERS TO SHIFT THEIR FORM OF RECREATION TO AVOID THE TAX. THIS DOES NOT SEEM TO FIT THE CRITERIA CONGRESS SET FOR ITSELF IN THE TAX REFORM EFFORT OF LAST YEAR.

I URGE YOU TO OPPOSE THE IMPOSITION OF THIS TYPE OF TARGETED, COUNTERPRODUCTIVE MEASURE.

RESPECTFULLY,

Samuel G. DeFalco
SAMUEL G. DEFALCO
OMC-CALHOUN PLANT MANAGER

Identical letter was submitted by the following:

Outboard Marine Corporation, Mr. D. F. Myers, Vice President, Marine Products, Waukegan, Illinois

Richard Schaefer
901 Euclid St. #1
Santa Monica, Ca. 90403
213-394-6838

July 20, 1987

Committee on Ways and Means,
1102 Longworth House Building,
Washington D.C. 20515

Gentlemen,

I am writing concerning a proposal in your committee to increase the fees and taxes regarding the marine and pleasure boat industry. Apparently, this plan is part of a larger scheme to reduce the budget deficit. I believe this plan is ill-conceived at best.

First, I don't think it's fair to single out the boating and marine industry in an effort to enhance revenue. Second, it occurs to me that the government of this country has spent money they didn't have for the last twenty five years and I don't believe the extra money collected would go to balance the budget, on the contrary, I think it would be perceived as a 'green light' for increased spending.

I can imagine how the boating public is thought of in Washington, 'Small voting block with deep pockets.'. This idea is generally untrue. The average pleasure boater is a middle class, working tax payer who chooses boating as a pastime and hobby over; buying an expensive four wheel drive and tearing up our wilderness areas, owning a $25,000 motor home to overcrowd and pollute our nations campgrounds, flying a private aircraft to make the skies less safe and creating a lot of noise pollution, or going on expensive vacations abroad and enhancing some other countries economy. I'm not saying these activities are wrong, as a matter of fact, I suspect that these hobbies are necessary to an individual's sanity in the 20th century. I merely wanted to point out that boating certainly isn't anymore extravagant than the other activities mentioned and that the old stereotype of the white capped 'yachtsmen' is rather outdated.

I don't believe that the answer to this countries budget problems lie in increased taxation, but in reduced spending. Reducing spending may not seem politically appealing in view of the fact that every year more and more people are the recipients of some sort of government program or giveaway, but the right course to travel in the long run is not always pleasant to travel initially.

Our country is founded on the principal of individual liberties and personal freedom, not on economic equality and the security of socialism. I would hope that you gentlemen would appreciate this historical mandate and therefore will work to reduce the size of government and it's role in our lives.

Sincerely,

Richard Schaefer

Bob Seldon
YACHT BROKER

July 25, 1987

House Ways and Means Committee
1102 Longworth House Office Building
Washington, DC 20515

Dear Committee Member:

PLEASE DO NOT DISCRIMINATE against the boaters and the boating industry!

The proposed 10% luxury tax and elimination of the second home mortgage interest deduction would be COUNTERPRODUCTIVE and UNFAIR.

The boaters are voters, but more importantly they are productive, employed work-a-day folks who typically forego other toys and hobbies to support their boats. Probably less than 2% are your "fat cats." They already pay sales tax, use tax, property tax, fuel tax, registration fees, etc. Enough is enough!

The boating industry employs thousands and thousands of people across the country and is just now getting on its feet from the recession. More unfair taxes lumped on those already imposed create "sticker shock" and lost sales. Lost sales mean less boats made, less parts made, etc. All of which mean less employed people paying less income and other taxes.

Your help in defeating these narrow minded and counterproductive proposals will help us all.

Thank you in advance.

Very truly yours,

Bob Seldon, Broker

BS:p

14120 Tahiti Way • Marina del Rey, California 90292
(213) 821-5883

LUXURY EXCISE TAXES - BOATS AND INELIGIBILITY OF BOATS AND MOBILE HOMES AS SECOND RESIDENCES

Dan Rostenkowski
Ways & Means Committee
1102 Longworth Building
Washington, DC 20515

Dear Mr. Rostenkowski,

I have been informed that the federal Government has come up with a 20 billion dollar short fall and that the Ways and Means Committee has been directed to make up the difference. It also has been brought to my attention that two of the possible ways that this short fall will be made up is by:

1. The elimination of the second home interest deduction on personal income tax.
2. The implementation of a 10 percent luxury tax on boats at a cost of 15,000 or more.

As a boat owner in the Pacific Northwest I would like to express my concern over this matter. I am by no means a wealthy person and have obtained my boat through hard work and careful budgeting of my personal finances. The implementation of a 10 percent luxury tax would mean that we could no longer afford the pleasure of boat ownership. I also feel that it would be a singling out of a small minority of the population which is perceived as being a wealthy class . On the contrary, most pleasure craft owners are people of retirement age, or are young working class people; neither group could afford such a tax, when the boating community is already taxed with license fees, usage fees and sales tax. This is also true of most recreational vehicle owners. Are you planning on taxing them in this manner also?

I would appreciate your views on this issue and further details on this bill and its impact on the pleasure boating sector of the marine industry.

I have been able to obtain my boat by staying within my budget. Why is it that because the Federal Government cannot stay within their budget I have to pay! If I were to overspend my budget and couldn't pay my taxes I would be jailed. Where is the justice! Let's find a way of raising the money that's fair for **EVERYBODY!**

I would appreciate a response at your earliest convenience.

Sincerely,

James D. Altman
310 No. Forest Street
Bellingham, WA 98225

Anacortes
Yacht Charters

July 14, 1987

Mr. Dan Rostenkowski, Chairman
Ways & Means Committee
1102 Longworth Bldg.
Washington, D.C. 20515

Dear Congressman Rostenkowski:

I would like to express strong opposition to the proposed elimination of the second home interest tax deduction or the implementation of a 10 per cent luxury tax on boats valued at $15,000 or above. These proposals are both discriminatory and regressive in nature.

If the second home interest deduction is to be allowed to continue for various forms of rental/vacation real estate and recreational vehicles then the elimination of the second home interest deduction for boats, which have full kitchen/bathroom facilities, would be blatantly discriminatory and unfair to an industry still trying to adjust to the tax law changes of 1986.

The possible implementation of a 10 per cent luxury tax on boats is ill-informed and would in essence destroy the recreational boating industry. This would be the most regressive form of tax legislation ever enacted by Congress. With this type of tax legislation it certainly would be logical to begin implementing luxury taxes on cars, airplanes, jewelery, etc. each and evertime the treasury incurred unexceptable defecits. This proposal simply cannot be taken seriously.

Both the proposal to eliminate the second home interest deduction for boats or the implementation of a 10 per cent luxury tax points out that Congress should either cut spending or begin to seriously discuss an income tax increase. Again I ask for your opposition to these proposals and that you closely examine the adverse impact such legislation would have on both the boating and tourist industries before acting. Thank you.

Sincerely,

Jim Shea Jr

Jim Shea, Jr.

JASJr/ks

P.O. Box 69
Anacortes Marina, Suite 2
Anacortes, Washington 98221
(206) 293-4555

BANK of WAUKEGAN

1601 North Lewis Avenue
Waukegan, Illinois 60085
Telephone 312-244-6000

Member FDIC

July 11, 1987

Congressman Dan Rostenkowski
Chairman, House Ways and Means Committee
2111 Rayburn House Office Building
Washington, D.C. 20515

Dear Congressman Rostenkowski:

It has been brought to our attention that the House Ways and Means Committee is considering a series of federal excise taxes and tax loophole closings to help produce added revenue to balance next year's federal budget. Among these are a proposed 10% luxury tax on boats over $15,000 in retail value and elimination of the interest deduction for boats and motorhomes used as second homes.

Lake County, Illinois prides itself on its many beautiful recreational areas made possible in large measure by our many inland lakes as well as Lake Michigan. The boating industry is obviously very vital to us, not only from an employment standpoint, but from a lending posture as well. A 10% luxury tax would propose a severe threat to our industry, because our marketing studies reflect that such a tax would reduce boat sales by 10% to 20% almost immediately. The reduction in boat sales would significantly impact our lending ability and profitability.

We are certain you realize the importance of the boating industry to Lake County and also comprehend how these proposed taxes would seriously jeopardize jobs and hamper the industry as well as the overall business climate.

With these thoughts in mind, we urge you to oppose the proposed luxury tax on boats in the House Ways and Means Committee staff option's paper and also to oppose the elimination of the second-home deduction for qualifying boats, unless all second-homes are similarly treated.

We would appreciate your response to this letter, advising us how you plan to vote on these critical issues. Thank you for your prompt attention to this matter, and we look forward to hearing from you in the near future.

Sincerely,

Charles E. Ofenloch
President

August 7, 1987

Congressman Dan Rostenkowski
2111 Rayburn House Office Building
Washington, DC 20515

Dear Congressman Chairman Rostenkowski:

All of the undersigned oppose the proposed luxury tax on boats and the elimination of the second home deduction for boats.

We are all boaters of average means and feel that this tax will place an unfair burden on recreational boating.

Would you please be so kind as to let us know how you will vote on this Proposal.

Very truly yours,
John Piech
John Piech
Commodore
Blue Skippers Boat Club

Margaret Piech	543 Prairie Ave	Calumet City IL 60409
Mr & Mrs [illegible]	674 E 161st St.	S. Holland IL 60473
Gary L. Brooks	15606 Woodlawn E.	So. Holland, Il 60473
Ted Ratajczyk	15606 Woodlawn E	S. Holland, IL 60473
Mr & Mrs [illegible] Blomquist	1019 Bloom Dr	Dolton, IL 60419
Mr & Mrs [illegible]	2805 E. 93rd St.	Chicago, Il 60617
Bobby [illegible]	14970 MARKHAM Dr	HARVEY Ill
[illegible]	[illegible]	[illegible]
Anthony McGinnis	10500 S. ARtesian	Chicago
[illegible]	10412 Pulaski Rd	Oak Lawn
Garrell [illegible]	9330 S Longwood	Chicago
E Gor	1381 River Dr	Cal CITY Ill
[illegible]	172 Park	Park Forest Ill

[illegible]	[illegible] Park	[illegible]
Tony [illegible]	19[illegible] Central Pk	[illegible], Il.
[illegible]	[illegible]	[illegible]
[illegible]	4223 [illegible]	Chicago, Ill
[illegible]	[illegible]	EVERGREEN PARK
[illegible]	[illegible]	[illegible]
Evelyn [illegible]	[illegible]	[illegible]
[illegible]	1750 Broadway [illegible]	Blue Island Il.
[illegible] Bell	2511 [illegible]	[illegible], Il
[illegible]	[illegible]	[illegible]
[illegible]	2[illegible]	[illegible]
[illegible]	[illegible]	[illegible]
Eugene J. Sparing	3 Thorn Creek	Park Forest, Il
[illegible]	3 Thorn Creek	Park Forest, Il
Jeanne Buttny	4840 S. Kilpatrick	Chgo, Ill
Dan Valsus	4438 S Knox	Chgo IL
[illegible]	44[illegible] S KNOX	CHICAGO ILL
[illegible]	44[illegible] S Knox	Chicago, Il
Michael J. [illegible]	5[illegible] W. 144th St	RIVERDALE, IL
Greg [illegible]	14[illegible] Chicago	Dolton Il

Bennett Boulden
P.O. Box 685
Salisbury, Maryland 21801

August 12, 1987

Chairman Don Rostenkowski
House Ways and Means Committee
1102 Longworth House Office Building
Washington, DC 20515

Dear Congressman Rostenkowski:

I am writing in protest to the staff proposals of your committee to levy additional taxes on the recreational boating community.

I can understand the great importance it is to our country to reduce our national debt, to find new sources of income to help reduce our deficit spending, and to work toward a balanced budget. Having been a boater for over forty years it is my opinion that recreational boaters are already paying more than their fair tax share through a maze of taxes and fees at the local, state and federal levels.

Surely the last thing we need is a luxury tax on boats. What a way to discourage boating in this country! If it makes sense to put a luxury tax on boats then why not a luxury tax on that second car or van or why not on a second home? What is fair for one is also fair for the other, right? Speaking of second homes, why should the mortgage interest on a second home be tax deductible and not on the boat that serves as a second home? Please lets be fair.

I don't mind paying my fair share of tax, and I am sure that other boaters feel the same way, but I do mind paying a disproportionate amount. Please see that your committee looks at all sides of this question before making their recommendation to the House.

Thank you.

Sincerely,

Bennett Boulden

Congressman Dan Rostenkowski (Chairman)
2111Rayburn House Office Building
Washington, D.C. 20515

Dear Congressman Rostenkowski;

It is my understanding that you are the Chairman of the House Ways and Means Committee, and your committee is presently developing legislation which would have a serious impact on me as an employee, on my job, my family, our company, and our community in general.

Your committee is presently proposing a 10% luxury tax on boats over $15,000 in retail value, and eliminating the interest deduction for boats used as second homes. I work for CARVER Boat Corporation in Pulaski, Wisconsin, a community of about 1800 people, over 1000 of which work at CARVER. Passing this legislation will have a severe impact on our business, including the strong possibility that I could be permanently released from my job here at CARVER. According to industry reports, this legislation could affect our business by between 20% to 30%, which means 200 to 300 jobs which would be lost here at the company, and in this small community.

I cannot believe that your committee has not taken this important aspect into consideration. If this is what could happen at CARVER, you can easily imagine what will happen throughout Wisconsin, in the marine industry, with over 145 marine manufacturers in this state alone!

I ask that you seriously reconsider passage of this legislation as a means of balancing the federal budget, and as an alternative raise the overall taxes, across the board for all, instead of focusing in on a few small groups.

I would appreciate a response from your office regarding how you feel about this issue, and what your committee's intentions are with respect to the legislation.

Sincerely,

Joseph E. Brosky, Jr.
1139 Roland Lane, Apt. #10
Green Bay, Wisconsin 54303

602 S. Hudson Avenue
Los Angeles, California
90005

August 2, 1987

Congressman Dan Rostenkowski
Committee on Ways and Means
1102 Longworth House Office Building
Washington, D.C. 20515

Re: Consideration of Imposing 10% Luxury Tax on Boats

Dear Congressman Rostenkowski:

Even though I do not own a boat at the present time, I have owned several boats in the past. Therefore, I feel that I do know quite a bit about the type and style of people who own small boats in our area. It is very obvious that the vast majority are not wealthy people with luxury yachts, but are actually distinctly middle-class people, who find their boats to be a relatively modest way of enjoying family recreation. On a national level, boat owners already pay more than their share of taxes, with excise, property, sales and use, registration fees, trailer licenses, and fuel taxes, that are estimated to total more than $500 million a year.

It has to be counter-productive to drive many people out of this sport, thereby certainly reducing the taxes already being paid, and also creating a large base of enmity by singling out boat owners as a group, to pay much more than their fair share. The provisions of the 10% luxury tax, the loss of second house mortgage interest expense deduction, and the disallowance of non-business personal property tax are all discriminatory and very unfair.

Sincerely,

Frank Capra Jr.

Frank Capra, Jr.

FC,Jr./ka

Chesapeake Bay
Yacht Clubs
Association

Commodore	Robert M. Ashwood
Vice Commodore	Ray M. Hart
Rear Commodore	Frederick Levitan
Secretary	James Eckart
Treasurer	Betty J. Davis
Qualifications Officer	Scott Mitchell, Jr

Acca Temple Yacht Club
Almas Temple Yacht Club
Aquia Harbour Yacht Club
Baltimore Yacht Club, Inc
Belvedere Yacht Club, Inc
Bodkin Yacht Club
Bohemia River Mariners Sailing Association
Bordentown Yacht Club
Boumi Temple Yacht Club
Bowleys Point Yacht Club
Bristol Yacht Club
Bush River Yacht Club
Capital Yacht Club
Chesapeake Bay Yacht Club, Inc
Chesapeake Commodores Club
Chesapeake Cruising Multihull Association
Chesapeake Sailing Association, Inc
Chesapeake Yacht Club, Inc
Choptank River Yacht Club, Inc
Classic Yacht Club of America, Inc
Colonial Yacht Club
Columbia Sailing Association
Corinthian Yacht Club
Crescent Yacht Club, Inc
Eastern Shore Yacht Club
Eastern Yacht Club, Inc
Edge Creek Boat Club, Inc
Fells Point Yacht Club, Inc
Fort Washington Yacht Club
Galloway Yacht Club
Georgetown Yacht Club
Golden Anchor Yacht Club
Goose Harbor Yacht Club, Inc
Great Oak Yacht Club
Green Hill Yacht & Country Club, Inc
Harbor Hills Yacht Club
Harbour North Yacht Club, Inc
Holiday Point Yacht Club
Kena Temple Yacht Club
Kennersley Yacht Club
Kent Island Yacht Club
Key Yacht Club
Khedive Temple Yacht Club
Lodge Creek Yacht Club, Inc
Lord Calvert Yacht Club, Inc
Lynnhaven Yacht Club
Marinette Owners Yacht Club
Marley Boat Club
Maryland Cruising Club, Inc
Maryland Yacht Club
Middle River Yacht Club, Inc
Miles River Yacht Club, Inc
Mount Vernon Yacht Club
Nabbs Creek Yacht Club
Nanticoke River Yacht Club, Inc
National Potomac Yacht Club
North East River Yacht Club, Inc
North Point Yacht Club
Nur Temple Yacht Club
Occoquan Yacht Club
Old Dominion Boat Club
Otter Point Yacht Club
Outcast Yacht Club, Inc
Pennsylvania Yacht Club
Quaker City Yacht Club
Rajah Temple Yacht Club
Red Eye Yacht Club, Inc
Richmond Yacht Club, Inc
Riverside Yacht Club of Maryland
Riverside Yacht Club, Inc of Pennsylvania
Rock Hall Yacht Club, Inc
Rose Haven Yacht Club, Inc
Rotary Yacht Squadron of Chesapeake Bay
Rotary Yacht Squadron of Delaware Valley
Salem Yacht Club
Sassafras River Yacht Club
Selby Bay Yacht Club
Solomon's Island Yacht Club
Spring Cove Yacht Club
Sue Creek Yacht Club
Sue Haven Yacht Club, Inc
Tantallon Yacht Club
Trojan Harbor Yacht Club
Ventnor Yacht Club, Inc
Virginia Yacht Club
West End Boat Club
West River Yacht Club
White Point Yacht Club
White Rocks Yacht Club, Inc
Wicomico Yacht Club of Wicomico County
Windmill Point Yacht Club

16 July, 1987

The Honorable Dan Rostenkowski
Chairman, House Ways and Means Committee
1102 Longworth House Office Building
Washington, D. C. 20515

Dear Chairman Rostenkowski:

We have been advised that before your committee for consideration are a multitude of possible revenue raisers to reduce the federal budget deficit, including a 10% luxury tax on boats over $15,000.00 in value, and that other provisions affecting boaters are:

(A) The elimination of the second home mortgage interest deduction for boats, akin to the highly unpopular and much criticized bill, S-624, introduced earlier this year by Senator Danforth of Missouri.

(B) The disallowance of non-business personal property tax - which includes recreational craft in the several states where it exists.

Chairman Rostenkowski, there seems to be a prevailing attitude that people who can afford to buy boats can afford to bear every conceivable tax that can be imposed. Seemingly every level of government has zeroed in on boating as though it were the fatted golden calf. Hence, boaters are being singled out and discriminated against to help bail out the general revenue programs, e.g. entitlement programs and defense spending that are rightfully the burden of all taxpayers.

Conversely, the overwhelming majority of boaters are struggling lower middle to middle income people whose efforts to make monthly installments on a boat represents a financial sacrifice in order to provide his family with the one wholesome recreational diversion that they can all enjoy. Only a very minute percentage fits the popularly conceived fat cat image.

Serving over 30,000 Yachtsmen
Charter Member of the National Boating Federation

Moreover, an additional taxation assuredly would be counterproductive. Already recreational boaters pay a disproportionate amount of taxes in the form of state imposed excise taxes, state personal property taxes, sales and use taxes, gasoline and diesel taxes, boat registration fees, boat trailer licensing, etc. Additionally, the Coast Guard is now proposing that we be assessed user fees. By continuing to heap one tax after another on the recreational boating community the government will drive a substantial number of people who cannot afford it out of the market. "Sticker shock" will depress boat sales, reduce factory work shifts, and in some areas force plant closings and job layoffs, and ultimately cost the government considerably more in lost corporate tax and worker income tax revenues than it could ever hope to gain from a luxury tax or elimination of boats' eligibility as second homes for mortgage interest expense deductions.

In view of these considerations we therefore urge that these extreme measures be stricken.

Thank you.

Respectfully,

Chesapeake Bay Yacht Clubs Association

James D. Finch

Past Commodore James D. Finch - 9241 Three Oaks Drive
Legislative Liason Officer Silver Spring, Maryland 20901

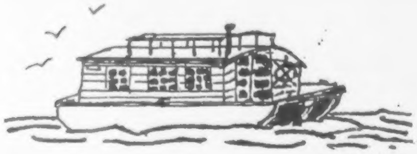
cc: Majority Members

Sam M. Gibbons, Fla.
J. J. Pickle, Tex.
Charles B. Rangel, N.Y.
Jim Moody, Wis.
Andrew Jacobs, Jr., Ind.
Harold E. Ford, Tenn.
Ed Jenkins, Ga.
Richard A. Gephardt, Mo.
Thomas J. Downey, N.Y.
Frank J. Guarini, N.J.
Sander M. Levin, Mich.
Marty Russo, Ill.
Donald J. Pease, Ohio
Robert T. Matsui, Calif.
Beryl F. Anthony, Jr., Ark.
Ronnie G. Flippo, Ala.
Byron L. Dorgan, N. D.
Barbara B. Kennelly, Conn.
Brian Donnelly, Mass.
William J. Coyne, Pa.
Michael A. Andrews, Tex.
Fortney H. Stark, Calif.

Minority Members

John J. Duncan, Tenn., Ranking Minority Member
Bill Archer, Tex.
Philip M. Crane, Ill.
Richard T. Schulze, Pa.
William M. Thomas, Calif.
Raymond J. McGrath, N.Y.
Hank Brown, Colo.
Guy Vander Jagt, Mich.
Bill Frenzel, Minn.
Rod Chandler, Wash.
Hal Daub, Neb.
Judd Gregg, N. H.
Willis D. Gradison, Jr., Ohio

Classic Yachts Etc., Inc.



Mailing Address
P.O. Box 98964
Des Moines Branch
Seattle, WA 98198-0964

(206) 824-1200

Location
Floating Office "L" Dock
Des Moines Marina

August 13, 1987

Mr. Dan Rostenkowski
Ways and Means Committee
1102 Longworth Building
Washington, DC 20515

RE: Elimination of second home interest tax deduction
Implementation of 10% luxury tax on boats over $15,000.

Dear Mr. Rostenkowski:

Reference is made in regard to the above.

If either of the two above issues are passed, the boating industry will not be able to survive.

We have been in the business for 12 years and have barely survived the taxes and regulations that are imposed upon the boater, but am sure this would be the "frosting on the cake".

Please understand the misconception that boating people are the "rich". This would include probably 2%. The rest of us make sacrifices to enjoy this recreation. We don't have motorhomes, cabins, planes, golf club memberships, etc. We are just participating in good family enjoyment and already paying a penalty for this recreation.

Please put forth every effort to abort the above action.

Sincerely,

CLASSIC YACHTS ETC., INC.

B E Miller

B. E. MILLER
Treasurer

Identical letters were submitted by the following of Classic Yachts Etc., Inc.:

P. T. Miller, Vice President, Seattle, Washington
M. A. Moen, Secretary, Seattle, Washington

Clyde M. Crocker
9037 6th NW
Seattle, Wn 98117

08/13/87

Dan Rostenkowski
Chairman, Ways & Means Committee
1102 Longworth Building
Washington, DC 20515

Dear Dan Rostenkowski:

I am writing to tell you how pleased I am to see someone finally taking a stand on the encroachment of rabble through the breach in the historical bastion of the Rich. It's about time we put boat ownership back into the hands of the rich where it belongs.

I have been continually sickened by the blatant and unabashed common folk frequenting the Boat Shows daring, without any embarrassment, to ask "How much does it cost?" And the boating industry itself has not only stood still for this appalling degradation to the point of answering the question, but actually perpetrates the outrage by posting the price lists in full view of any Joe Doakes walking by.

I am filled with such relief to hear that the Federal Government has finally awakened to this threat to the Nation's Security.

I was pleased to hear the first rumors that the Interest Deduction might be removed for boats as a second home, but I too was fearful it wouldn't be enough to drive the vermin off of the water.

What a beautiful, perfect solution to the problem - a 10% Luxury Tax. Of course, it won't apply to commercial boats, so the Rich can still buy any boat they wish through corporate camouflage. But not the rabble. Oh, no!! Not them!!

Hey, they can still buy a nice 21 to 24 footer for $15,000. But they won't be able to afford a REAL Boat, and we'll finally be able to once again tell the Haves from the Have-nots.

Next, we'll have to work on getting the Rules of the Road changed so it's ok for big boats to run over little boats.

Then we'll have to see about who's buying Motorhomes. If its any smaller than a requires a Commercially licensed Driver, tax it.

Airplanes. That's a good one. Anything without a jet engine on it can be taxed.

And houses. Anything with more than two rooms including the kitchen and bathroom, but not anything with more than 20 rooms. It's not like you can use them all for personal use.

Cars? Oh, yes. If it isn't chauffeurred ...

I'm one of the rabble and I'm selling my boat with the intention of buying bigger. If either of these "options" goes into existence, the chances of selling and/or buying diminishes. If the Luxury Tax passes, the odds are against selling, and I will NOT buy.

10% of nothing -- Well, you get the idea.

Thank you

Clyde M Crocker

Clyde M. Crocker

CRUISING
WORLD
West Coast Office
903 5th Avenue, Suite 201
Kirkland, WA 98033
(206) 828-0583
FAX (206) 822-2621

July 13, 1987

Chairman Dan Rostenkowski
WAYS & MEANS COMMITTEE
1102 Long Worth Building
Washington, DC 20515

Dear Chairman Rostenkowski,

The Sailing Industry's annual sales have dropped from 143,000 units in 1974 to 37,200 units in 1986! A 74% reduction.

The mortality rate of U.S. manufacturers is appalling.

We hear continuous talk about bolstering U.S. manufacturing on one hand, while on the other, we hear talk of, not only eliminating the SECOND HOME INTEREST TAX DEDUCTION but now, the IMPLEMENTATION OF A 10% LUXURY TAX on boats valued at $15,000 and up.

Where is the support for U.S. manufacturers?

I strongly urge you to champion U.S. industry by voting against both issues:

> ELIMINATION of the SECOND HOME INTEREST TAX DEDUCTION
> and IMPLEMENTATION of the 10% LUXURY TAX ON BOATS

Sincerely,

James R. Gray

James R. Gray
Western Regional Manager

JRG:lam

Editorial, Advertising, and Business Office, 524 Thames St., Newport, Rhode Island 02840 (401) 847-1588
NYT
A New York Times Publication

Dagmars Landing
1871 Ross Avenue
Marysville, Washington 98270
Phone (206) 259-6124
Smith Island, Everett

July 21, 1987

Dan Rostenkowski, Chairman
Ways & Means Committee
1102 Longworth Building
Washington, DC 20515

Dear Chairman Rostenkowski:

It is our understanding that the House Ways & Means Committee is considering two options to help eliminate a $20 Billion shortfall in the federal budget:

1) the elimination of the second home interest tax deduction on personal income tax; and

2) the implementation of a 10 percent luxury tax on boats selling for $15,000 and over.

Both of these options will seriously affect the marine industry as a whole, resulting in a loss of tax dollars not a gain, as boat sales and moorage revenues decline. Boat sales have already been seriously impacted in Washington State due to the loss of the sales tax deduction. There should be no reason to penalize the boating industry further.

Your cooperation in alleviating our concerns will be appreciated.

Sincerely,

DAGMAR'S LANDING

Victor M. Loehrer
Partner

VML/aef

Elliott Bay Yachting Center*

July 10, 1987

Mr. Dan Rostenkowski, Chairman
Ways & Means Committee
1102 Longworth Building
Washington, DC 20515

Dear Chairman:

It is with a good measure of shock and dismay that I read of the House Ways & Means Committee's proposal for raising revenue to counter the shortfall we are suffering, namely the proposal for elimination of the second home interest tax deductions, and the 10% luxury tax on boats over $15,000 are in question.

I can think of nothing that would be more devastating to our marine industry short of a law curtailing the distribution of all boats over $15,000. It seems to me to be nothing more than a short-sighted, band-aid fix for a long-term problem. Let's not be hasty in throwing out proposals such as this one, without a great deal of thought given to the ripple effect, or, in the case of our business the tidal wave effect it would cause.

Needless to say, in the interest of survival, we would very much like you to eliminate these proposals from your list of possible fixes.

Thank you.

Sincerely,

Michael S. Elliott, President
Elliott Bay Yachting Center

1800 Westlake Avenue North, Suite 101, Seattle, Washington 98109 (206) 285-9499
*A division of The Elliott Bay Yacht Company

PATRICIA J. GOOD
6832 16th Avenue Northeast
Seattle, Washington 98115
Telephone 206-527-9478

July 31, 1987

Dan Rostenkowski, Chairman
Ways & Means Committee
1102 Longworth Building
Washington, D. C. 20515

Dear Representative Rostenskowski:

I have read with alarm in several boating publications the options being considered by the Ways and Means Committee to make up for budget shortfalls. One of those options is the elimination of the second-home, interest tax deduction for boats on personal income tax and the second is the implementation of a 10% luxury tax on boats at a cost of $15,000 and up. Both options appear extraordinarily unfair.

There are (at least) two kinds of boaters: (1) those who use their boats for occasional waterskiing or an afternoon of fishing (such boaters are well known throughout the United States); and, (2) those who use their boats as a true primary or secondary residence (boaters in this class, of course, have little visibility in the interior states). I belong to the second class of boaters. I have a 26 foot sailboat on which I spend many complete weekends of the year as well as extended vacations. The boat has all the requirements of a residence (head, sleeping accommodations for five, galley, etc.) and I certainly spend as much time aboard, if not more, as do my acquaintances who have land-bound second homes.

If budget shortfalls are to be remedied, and tax reforms undertaken, then let them be equitable. There is simply no equity in placing the horrendous financial burdens contained in the proposed tax options upon one group of individuals who prefer to have their second homes on the water (and of a different shape), while continuing to give preferential treatment to those who spend their weekends and vacations on land. In effect, the options penalize individuals because they live in coastal states and own boats large (and costly) enough to actually be second homes.

I hope that when final action is taken, the solution will involve a shared responsibility that will not fall so heavily and unfairly upon a single group. I also hope that you will communicate my concerns to members of your committee.

Sincerely,

Patricia J. Good

TO: The Hon Dan Rostenkowski,

Chairman, House Committee on Ways and Means

Ref: The House Tax Writing Committee consideration of:
1. A luxury tax on BOATS
2. Removal of the second-home mortage cost exemption for boats.
3. Elimination of the non-business personal property tax exemption.

Item 1. Most of the (minority) middle class boat owners use their boats to provide wholesome activities for their families, and have had to work many extra hours in the acquisition, maintenance, and use of their boats. Should we be penalized for keeping our kids off the streets and teaching them useful, community enhancing activities?
Any expensive, luxurious, Party-type yacht, (or Jet aircraft) is probably being used for Corporate entertainment, and is therefore exempt as a business expense, while this Tax would burden the working, family tax payers.

Item 2. Boats cost about the same as a "house in the country" or a "House on the Lake", etc, and the Boat used as a second vacation home is used the same way, for family recreation, and is probably used more days per year. Why should you exempt the House BY the lake, and Tax the Houseboat IN the lake?

Item 3. Whether your personal property is a boat, ski-lodge, swimming-pool, or any other type of life enhancing system, it is there because people worked extra time to build or buy that item, creating new jobs in the process, and they should NOT be punished for such positive activities.
Discrimination is intolerable in taxation or any other facet of life. Presently we reward with exemptions and welfare the large families which create the crime, welfare, and health-care burdens, and it would be unfair to single out and punish the families that work overtime, buy materials, and build themselves a second-home that floats. Ridiculous.
Please give fair-treatment TO THE WORKING CLASS, serious consideration.

Thank you,

Caroline Grounds and Gerald Grounds
2275 West 25th St
San Pedro, Ca. 90732

Jason
Hailey

7539 West 83rd Street
Playa Del Rey, CA 90293

Mr. Dan Rostenkowi , Majority Chairman

Committee on Ways and Means
1102 Longworth House Office Building
Wasington, D.C. 20515

Dear Congressman Rostenkowi -

I am opposed to the consideration by the Writing Committee of a 10% luxury tax and elimination of the mortage interest deduction for boats.

My boat was acquired through years of hard work and savings ... a massive committment to recreational activity.
Many like myself are retired with limited income to support this highly desired later-life enjoyment to share with our families.
The average boater is not wealthy !

As you might know, there are many continual expense increases in recreational boating.
This additional tax and expense deduction elimination now being considered would seriously imperil my hope of keeping "ARGO" and remaining in boating.

Such a tax is unreasonable, inapppropiate and detrimental to affordable recreation.
It is clearly unfair and discriminatory to the boating taxpayer.
Tax burdens rightfully are the burden of all taxpayers !

I urge you to oppose such proposals under consideration by the House Tax Writing Committee.

Sincerely and Sail On -

Jason Hailey
skipper - ARGO

July 20, 1987

11 August 1987

Dan Rostenkowski, Chairman,
Ways & Means Committee,
1102 Longworth Building,
Washington, D.C. 20515

Dear Sir:

I'd like to call your attention to two bills which are under consideration by your committee. They are the bills to eliminate interest tax deductions for interest paid on a boat used for a second home - and - the proposed luxury tax on boats costing over $10,000.

I understand and am in sympathy with the need to raise taxes. My only concern with these two bills is that they should not be aimed solely at the boat owner. These things are no more of a luxury than motor homes - indeed, many motor homes cost far more than I could afford.

Please consider that, in the interest of fairness, these bills should be applied to all major "luxury" items instead of one narrow segment of economy. Thank you for your consideration of this matter.

Very truly yours,

Morris D. Hazel

Morris D. Hazel
4710 118th St., N.E.,
Marysville, Wa. 98270

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CENTRAL STAFF OFFICES

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Telecopier 616-775-2661

July 13, 1987

The Honorable Dan Rostenkowski, M.C.
Chairman
House Ways & Means Committee
2111 Rayburn House Office Building
Washington, D.C. 20515

Dear Congressman Rostenkowski:

It has come to my attention that legislation is being contemplated by the House Ways and Means Committee to introduce tax legislation that could cost our Michigan and Florida boat components companies a 20-40% loss in their business. This will impact from 100 to 200 jobs directly and reduce our profitability to unacceptable levels which will also reduce the taxes our employees pay and our company pays.

I understand these taxes to be forthcoming in the form of federal excise taxes

- A 10% luxury tax on boats over $15,000 in retail value.
- Elimination of the interest deduction for boats and motor homes used as second homes.

When the British boating industry was faced with a similar tax in 1979, the industry went into the deepest recession in its history.

Please advise me on how you view this issue and how you plan on voting.

Sincerely,

Timothy J. Campbell
Group Vice President

TJC/eh

Tracy Lewis
Post Office Box 17421
Seattle, WA 98107

August 11, 1987

Dan Rostenkowski, Chairman
Ways & Means Committee
1102 Longworth Building
Washington, DC 20515

Dear Sir,

I was recently informed of the federal goverments $20 billion shortfall and the House Ways and Means Committee possible solutions/options to make up the necessary revenue by:

1. The elimination of the second home interest tax deduction on personal income tax; and,

2. The inplementation of a 10% luxury tax on boats at a cost of $15,000 and up.

I would like to express my strong opposition to both of these measures. It seems that the general public views boat owners as wealthy people, and indeed there are many rich boat owners. However, many boaters (the numbers are growing) can only afford a "pleasure craft" by living aboard. The taxes are currently difficult to keep up with and a bill such as this would be devastating. Please let us continue to live our version of the American dream. If the above bill is past boating will truely be only affordable to the very wealthy. We are counting on you!

Sincerely,

Tracy Lewis

LIBERTY
(206) 282-0401 Yachts 2900 WESTLAKE AVE. N. SEATTLE, WASHINGTON 98109

July 8, 1987

Dan Rostenkowski
1201 Longworth House Office Building
Washington, DC 20515

Dear Chairman Rostenkowski,

The proposed federal luxury tax on all pleasure boats over $15,000 has just come to my attention as well as the possibility of eliminating the second home interest tax deduction on personal income tax.

Please register my loud "NOT IN FAVOR" vote of these proposals. The marine industry is a difficult area to make a living in as it is without having to constantly struggle with our legislators to treat us fairly and honestly. It seems as though the boating industry is already paying more than its fair share of its taxes without adding more to it. If additional taxes are tacked on to the already-overburdened marine industry, you can be sure of practically eliminating the entire pleasure boat industry.....and then there will be no taxes to be gained.

We sell live-aboard yachts wherein people sell their homes and the yacht becomes their primary home. We feel that ordinary home-owner's taxes are fair and equitable but it should be realized and understood by legislators that all boats are NOT pleasure boats, some are our primary homes.

Sincerely,

Joan K Hoyt

Joan K. Hoyt

Identical letter was submitted by the following:

Passport Yachts, Inc., Peter B. Hoyt, Seattle, Washington

PASSPORT
YACHTS, INC.

2900 Westlake Avenue North, Seattle, WA 98109
(206) 282-0401

July 8, 1987

Dan Rostenkowski
1201 Longworth House Office Building
Washington, DC 20515

Dear Chairman Rostenkowski,

The proposed implementation of a federal luxury tax on all pleasure boats over $15,000 in value has just come to my attention. The possibility of eliminating the second home interest tax deduction on personal income tax has also just come to my attention.

Please understand my strong opposition to these proposals. It is based upon the following reasons:

1. Valuation of a Yacht is next to impossible for a buyer or seller or a surveyor or a banker or even a state tax assessor to agree on. We have no tax roles to consult, very few two boats are of the same condition, with the same amount of equipment as others on the market. If you've bought or sold a boat recently you'll know it's true. It's tough as nails to fix a price on existing boats. Condition and equipment play a large part in fixing the price, as do other things like the state of our economy and interest rates.

2. If we assess a tax on new or used boats being sold the obvious impact will be a decrease in boat sales. As both a boat owner and a boat dealer this is not an attractive option.

3. If additional taxes are tacked on to the already-overburdened marine industry, you can be sure of practically eliminating the entire pleasure boat industry.....and then there will be no taxes to be gained.

4. I sell live-aboard yachts. I live aboard a yacht myself (Well I call it a yacht. Others think it's a thirty-three foot sail boat). When we live aboard we pay a sales tax when we buy the boat(7.9%), a boat tax and an excise tax. We pay our moorage rates which include a portion of the property tax the moorage owner pays. Living aboard a yacht (33 feet) does not seem like a real luxury, and the idea of paying a luxury tax is comical, especially as we sit below in a Seattle rain trying to plug deck leaks. Granted the are many boats far more luxurious than mine but how will you differentiate between what is a luxury and what is not? What's a home and what's a yacht? When is a second home a luxury or when is it a yacht?

PASSPORT
YACHTS, INC.

2900 Westlake Avenue North, Seattle, WA 98109
(206) 282-0401

5.) The idea of elimination of the second home income tax deduction would not only hurt those in our business, but also hurt those in the housing industry and other industries. We need this deduction. All of us do.

I strongly belive that tax incentives promote a stonger economy. I realize that you are in a difficult situation and need to increase revenue. I know when I'm in a similar situation I need to sell more boats and spend less money. Obviously you're not in the boat selling business, but perhaps instead increasing revenue you'll take the responsibity to decrease spending. My wife and I cut down on our beer and wine budget and take the bus. Perhaps you might speek up to cut down a bit on our defense budget.It won't take away from our security.

Regardless of how you decide to spend less, don't implement a luxury tax. Speak out against it. And don't eliminate the second home interest tax deduction. It helps all of us. And if you'd like to talk with someone about the potential consequences of these tax reforms should they be put in action, I'd like to make myself available to you.

And when you're ready for a break, want to retire or take a vacation, come take a look at our boats. They're priced fairly, very well built, and definitely a necessity for one's sanity when signs of stress persist.

Sincerely yours,

Andy Peters

JOHN S. RENN, M.D., F.A.C.S.
ORTHOPEDIC SURGEON

August 5, 1987

Dan Rostenkowski, Chairman
Ways & Means Committee
1102 Longworth Building
Washington, DC 20515

Dear Senator:

I am most concerned over the possibility of eliminating boats as a second home. Apparently there is some effort to do so, presently brewing within the congress. Many of us who do own larger boats, do so in lieu of second homes or vacation property. To not be permitted to utilize this as a second domicile is totally unfair. I have a practice in Puyallup, Washington and work part-time in Seattle where I live aboard my sailboat. My boat is definitely used as a second home and in lieu of a second home or a vaction property. I would not mind loosing the interest payment deductable so long as it would be an equitable, across-the-board maneuver that those people with large motor homes, vacation properties, second homes and airplanes would also be similarly treated. In order to avoid screams of unfairness, I understand that now the ploy is to possibly pass a luxury tax on boats over $15,000. Again, I would protest this maneuver feeling that it would be grossly unfair, if the boating industry and boat owners themselves are fingered for this new tax. Again, so long as motor home people owning airplanes, motor homes, vacation property and second homes are similarly taxed I think there would be a mass movement toward a class action suit involving the unconstitutionality of such a preferential and prejudicial tax. Boat owners are already being preferentially taxed in this state where we are required to pay a boat tax when owners of large motor homes, expensive horses and airplanes are not being taxed. I would trust that Washington State would act as a leader being opposed to this type of preferential treatment.

Sincerely,

John S. Renn

John S. Renn, M.D.

JSR:jw

10317 · 122ND STREET E. • PUYALLUP, WASHINGTON 98374 • (206) 841-0606/841-8103

YACHTS

July 8, 1987

Chairman Dan Rostenkowski
Ways and Means Committee
United States House of Representatives
1102 Longworth House Office Building
Washington, DC 20515

Dear Mr. Rostenkowski:

I understand that Congress is considering heavy taxes which would have a tremendously negative impact on the boating industry. The purpose of this letter is to document my position and those of my peers in the industry who are fully aware that a 10% Federal luxury tax on boats and the elimination of second home interest deductions for boats would have a devastating effect on our industry.

One of the few growing business segments within the United States, as reported recently by the Wall Street Journal, is the sustained growth rate of 8% to 12% found in the recreational industry. This is in vast contrast to the manufacturing jobs which are constantly being lost within the heartlands of America. A luxury tax on boats and the elimination of the second home deduction, for qualifying watercraft, would immediately put thousands of jobs in jeopardy. Its immediate effect on sales would be similar to that of the Carter Administration's weekend standby boating ban as a symbolic energy conservation measure eight years ago. The real impact of such a luxury tax and disallowment of a second home deduction would be to produce a net revenue loss to the government. Last year's tax reform act, which was revenue neutral and passed to make the tax code fair in its application, would be reversed to the earlier legislation if it were to now single out certain products, including boats, for "so called" luxury taxes. Clearly, the fairest method to raise additional revenues is the most broad tax possible.

I, along with all of my constituents in the industry, will bring any and all resources to bear to support you in your efforts of recognizing the dangerous and far reaching negative implications such actions would bring to our industry.

I would appreciate hearing your position. This will enable me to advise my constituents as well as the 500 employees of my firm whether or not you are supporting us. I believe there are nearly 15,000 people in the state of Michigan alone that would be negatively impacted by the effects these actions would have on the marine industry.

Sincerely,

J. C. Swan
Vice President, Sales

JCS/sst

Eric R. Sorensen
12614 Milton Street
Los Angeles, California 90066
(213)838-0933

July 31, 1987

Congressman Dan Rostenkowski, Chairman
Committee on Ways and Means
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Congressman Rostenkowski:

It has just come to my attention that the Committee on Ways and Means is considering a new tax on recreational boaters, as well as disallowing several tax deductions which we are currently entitled to. This letter is to express my concern with the apparent image in Congress that all boaters are "fat cats" that should be taxed for the privilege of owning a boat.

We are not "fat cats." We are no different than the people who own condominiums in resort areas and use them as second homes, or the people who own recreational vehicles and use them on weekends. We work hard, save our money and sacrifice in order to buy our boats.

I personally own a boat that cost $15,000. My wife and I use it as our second home. We spend weekends there and usually take our vacations on it. In other words, we use the boat in exactly the same manner that our neighbor uses his cabin in the mountains. The only difference is that his second home is attached to land, while ours floats on the water.

Boaters don't want to be given special consideration, we only want to be taxed the same as everybody else who owns a second home or a recreational vehicle. I would appreciate your rational and reasonable consideration of this. Please treat us the same as any other property owner.

Very truly yours,

Eric R. Sorensen

SEN. DAN ROSTENKOWSKI
WAYS + MEANS COMM.
1102 LONGWORTH BLDG.
WASHINGTON. D.C.

AUG. 6, 1987

DEAR SENATOR

THIS NEW IDEA OF A 10% TAX ON BOATS HAS TO BE ONE OF THE WORST IDEAS IN RECENT YEARS, ALREADY BOAT SALES ARE 1/2 DEAD, THAT WOULD REALLY FINISH IT OFF.

WE *ALL* KNOW THE GOVT. NEEDS MONEY, IT *ALWAYS* DOES!

BUT THIS PROPOSAL IS THE ALL TIME LOW. STICK IT TOO THE BOATERS *AGAIN*

THE STATE JUST GOT THRU SHAFTING US, NOW UNCLE WANTS SOME.

WHEN WILL YOU PEOPLE IN PUBLIC OFFICE UNDERSTAND THAT BOATS ARENT ALWAYS A LUXURY. SOME TIMES IT IS THE *ONLY* THING

(2)

YOU HAVE.

NOW I DONT SEE WHY PEOPLE WITH 2ND HOMES SHOULD HAVE A TAX DEDUCTION, THATS DUMB TOO, BUT IF YOUR BOAT IS YOUR ONLY HOME, WHY NOT?

SURELY YOU GUYS CAN COME UP WITH SOME TAX IDEAS THAT ARE MORE FAIR SO THAT EVERYONE SHARES IN PAYMENT, WE ALL SHARE IN THE BENEFITS.

SINCERELY
P. E. Stoppelman

P. STOPPELMAN
777 N. SUNSET DRIVE
CAMANO ISL., WA 98292

Striker
THE FINEST SPORTFISHING YACHTS IN THE WORLD
JERRY RUDNITSKY

August 11, 1987

Congressman Dan Rostenkowski, Chairman
Committee on Ways and Means
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Chairman Rostenkowksi:

The luxury tax proposal before your committee, that recommends a 10% tax on boats, could be devestating to manufacturers of large yachts. This concept, coupled with that of eliminating the second home interest deduction for boats, will play havoc with our industry.

The state of Florida is completely entrenched in the marine industry and it is the states second largest employer (tourism holds the number one position). These recommendations, if passed, would cripple us and lead very quickly to a serious unemployment problem. Consider please, not just the boat manufacturers, but all the industries tangential to manufacturing and the wide spread devistation that would occur to Florida's economy.

I hope you will direct your committees efforts elsewhere in lieu of the problems these suggestions would create as opposed to any solutions you might expect from them.

Thank you for your consideration.

Respectfully,

Jerry Rudnitsky
Executive Vice President

JR/wa

Striker Yachts
1489 S.E. 17th Street
Ft. Lauderdale, Florida 33316
(305) 522-7200 Telex: 51-4486-Striker FTL

YACHTS WEST 811 13th St. • Everett, WA 98201 • (206) 259-3157

August 5, 1987

Dan Rostemowski
Ways & Means Committee
1102 Longworth Building
Washington DC 20515

Dear Congressman,

We understand that the House Ways and Means Committee is trying to make up the shortfall in the budget by, among other things, considering elimination of the second home interest tax deduction on personal income tax and by introducing a new luxury tax on boats. We would sincerely hope these do not receive serious consideration as either of these items would have a devastating effect on our business. The sale of both new and used boats are directly affected when the government creates additional costs on these purchases. This was felt very strongly in our business this year, due to the elimination of the sales tax deduction on personal income tax, and because of the confusion on whether interest on boat loans will be an allowable deduction. The first five months of this year were the worst our company has experienced since 1983, and in discussions with potential boat buyers, the income tax reforms were stated as the reasons why.

We are unquestionably opposed to adding additional taxes to such a select item of purchase without consideration of the effect on the businesses which barely stay in the black in good sales times. In the State of Washington this type of additional tax could easily cause a loss of revenue greater than the tax would provide (via lost Business Tax, Sales Tax, etc.). And unfortunately, the boat brokers such as Yachts West may have to close their doors !!!!!!

Very concerned,

Rick Gordon

Rick Gordon and Paul Dukich
Owners

LUXURY EXCISE TAXES - GENERAL AVIATION AIRCRAFT

ATLANTIC AVIATION

W L PATRICK
President

August 10, 1987

The Honorable Dan Rostenkowski
2111 Rayburn
House of Representatives
Washington, DC 20510

RE: Proposed 10% Luxury Tax on Non-Commercial Aircraft

Dear Mr. Rostenkowski:

Non-commercial aircraft are important business tools for today's businessmen. These aircraft fill a real need that cannot be met by our airlines. Large companies as well as small and medium-size companies have made and continue to make use of these aircraft in their business. They are not luxuries but earn their keep through effective use. They play a vital role in our transportation system.

Non-commercial aircraft are in what is called General Aviation. This part of aviation has been hurt by poor economic conditions for the past five years. New aircraft sales had just about reached the stopping point and are slowly recovering. This has hurt the manufacturers, suppliers and support companies (such as mine) severely.

As a result of this economic turndown, Atlantic has reduced its staff by 25%. We suffered through reduced earnings and three year-after-year losses. Only now do we see any encouragement.

The non-commercial aircraft market is very price conscious. Prices have been driven down by the bad economic conditions to a point where the market is just starting to respond. The proposed ten percent tax on these aircraft will severely hurt this industry, which is already on its knees. It will hurt the growth of my company and its ability to maintain its employment levels.

Please do not put a 10% tax on non-commercial aircraft. General Aviation is an industry in need of help.

Sincerely yours,

ATLANTIC AVIATION CORPORATION

W L Patrick

W. L. Patrick
President

WLP:pan
Encl. - Non Commercial Aircraft Sales in U.S. 1979-1987

ATLANTIC AVIATION CORPORATION · GREATER WILMINGTON AIRPORT, P.O. BOX 15000, WILMINGTON, DELAWARE 19850-5000 · (302) 322-7213 · TELEX 83-5333

General Aviation Shipments

Year	Piston (U.S. Only)	Turboprop Worldwide	Jet Worldwide	Total
1979	16,355	701	395	17,451
1980	10,166	799	456	11,421
1981	8,103	945	559	9,607
1982	3,611	438	433	4,482
1983	2,298	288	269	2,855
1984	1,903	202	267	2,372
1985	1,566	222	230	2,018
1986	1,090	124	179	1,393
1987 (Forecast)	537	126	188	851

Sources: All years are from Data Resources Inc. except 1979, which is taken from The Weekly of Business Aviation.

Piston down 96.7% from peak year 1979

Turboprop down 86.6% from peak year 1981

Jets down 66.3% from peak year 1981

WLP:pan
8/10/87

FalconJet

July 22, 1987

The Honorable Dan Rostenkowski
Chairman
Committee on Ways and Means
United States House of Representatives
1102 Longworth
House Office Building
Washington, DC 20515-6348

Dear Congressman Rostenkowski:

Falcon Jet Corporation has learned of recent options discussed by the House Ways and Means Committee regarding a possible "luxury tax" on business aircraft purchases. The Joint Committee on Taxation has issued a document outlining potential revenue-generating measures which includes an option to levy a 10% tax on new business aircraft purchases.

It is apparent that the Committee is not fully aware of the ramifications of this tax on the manufacturers and users of business aircraft, or the fact that the vast majority of these aircraft are used for highly productive and otherwise impossible missions for American business. Airline deregulation coupled with the need for companies to quickly access remote facilities has contributed to the recognition of business aircraft as legitimate "tools" of industry.

The tax proposed would impose a severe burden on purchasers of business aircraft who, just last year during tax reform, lost the 10% Investment Tax Credit. This "luxury tax" is essentially doubling the financial impact on companies who actually rely on the aircraft to conduct business more efficiently.

One of the major pitfalls of the "luxury tax" is its impact on aircraft production and consequentially, employment. More than fifty per cent of the dollar value of our Falcon Jets is derived from parts and equipment supplied by US manufacturers and our company employs more than 1000 workers in this country.

Although we understand that this proposal is only a recommendation at this time, we strongly urge that any mention of a "luxury tax" on business aircraft be deleted from the document. The mere fact that this "luxury tax" may be considered as an option indicates a major misconception about business aircraft use among members of the House Ways and Means Committee.

Should you require further clarification of Falcon Jet's position on this matter, please feel free to contact the undersigned.

Very truly yours,

Roy E. Bergstrom
Senior Vice President
Marketing

JRWA
James R. Wikert & Associates, Inc.

Raymond A. Brown
Vice President

July 17, 1987

The Honorable Dan Rostenkowski
Chairman, House Ways and Means Committee
United States House of Representatives
2111 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Rostenkowski,

I support the difficult task of the Congress and the Administration to seek alternatives providing for the much required balancing of the Federal Budget.

However, I think a proposal being considered by your "Committee" wherein a 10% luxury tax would be imposed upon the sale of non-commercial aircraft would be wholely unfair and further devastate the "General Aviation Industry" which has not yet even begun to recover from the recessional period of the early 80s'.

Industry records will support that the great majority of "General Aviation Aircraft" purchased today are acquired for business purposes. The corporate and individual businessman's requirement to travel is in direct support of activities which provide for the manufacturer of goods and services. The success in productively providing these goods and services to the world marketplace ultimately will, through taxation of profits and wages, provide additional revenues to the treasury.

I believe it is inappropriate to consider the "business aircraft" a luxury item subject to a 10% luxury tax and respectfully request your support in recognizing that the "business aircraft" is a productive capital asset like computers, machine tools, office building, manufacturing plants and other capital assets.

Sincerely,

Ray A. Brown

Raymond A. Brown

Dallas Love Field • P.O. Box 9220 • Dallas, Texas 75209 • (214) 353-0303 • FAX (214) 353-0304 • TWX 510-600-5140

JRWA
James R. Wikert & Associates, Inc.

Charles G. Collins
Vice President

July 17, 1987

The Honorable Dan Rostenkowski
Chairman Ways and Means Committee
United States House of Representatives
2111 Rayburn House Offices Building
Washington, DC 20515

Dear Chairman Rostenkowski:

It has been brought to my attention that the Joint Committee on Taxation's, "Description of Possible Options to Increase Revenue" prepared for the Committee on Ways and Means has classified airplanes along with yachts, china, crystal, VCR's and Social Club dues as luxury items.

I believe this to be in error. Airplanes are a business tool. They are as productive in their use and computers, machine tools and other capital equipment.

I respectfully request that the proposal be discarded from active consideration and general aviation be taken out of the luxury category.

Sincerely,

Charles G. Collins
Vice President

Dallas Love Field • P.O. Box 9220 • Dallas, Texas 75209 • (214) 353-0303 • FAX (214) 353-0304 • TWX 510-600-5140

W. D. Jugeleit
Box 91, Rte 8A
Ancramdale, N.Y. 12[redacted]

July 17, 1987

Dear Mr. Rostenkowski:

I was recently informed that you plan to put a 10% luxury tax on airplanes. I own an airplane, it cost all of $6900.00. I live on a farm and I bought it because there is a 100 mile trip I have to make once a week. This trip would take me 3 hours each way by car and by plane it takes only 45 minutes.

There is a guy down the road, a stock brocker, he owns a 500 acre horse farm and 2 fancy Mercedes cars. Now you're telling me, that my plane is a luxury and his $45,000.00 car is not.

Sir, I submit, you have your priorities mixed up.

Sincerely yours

TAYLOR MOTORS INC.
BUICK • PONTIAC • GMC TRUCK

July 17, 1987

Mr. Dan Rostenkowski, Chairman
House Ways and Means
Washington, D.C.

Please strongly reconsider the proposed 10% luxury tax on aviation aircraft. Someone surely must have mislead your committee into thinking general aviation is a luxury. Only a small portion is done for pleasure. We, as examples, live in a far removed area of the Sacramento Valley from large cities; we must travel a lot and you know there are only a few good airline connections. Personally, I suspect that our representatives are trying to crush general aviation. We need new highways -- ours are in atrocious condition; you set 55 mph and 65 in a few areas. I really don't know how much more you can inflict on business people -- are you trying to crush small business people, too? Why do we let you do the things you do?

Urgently,

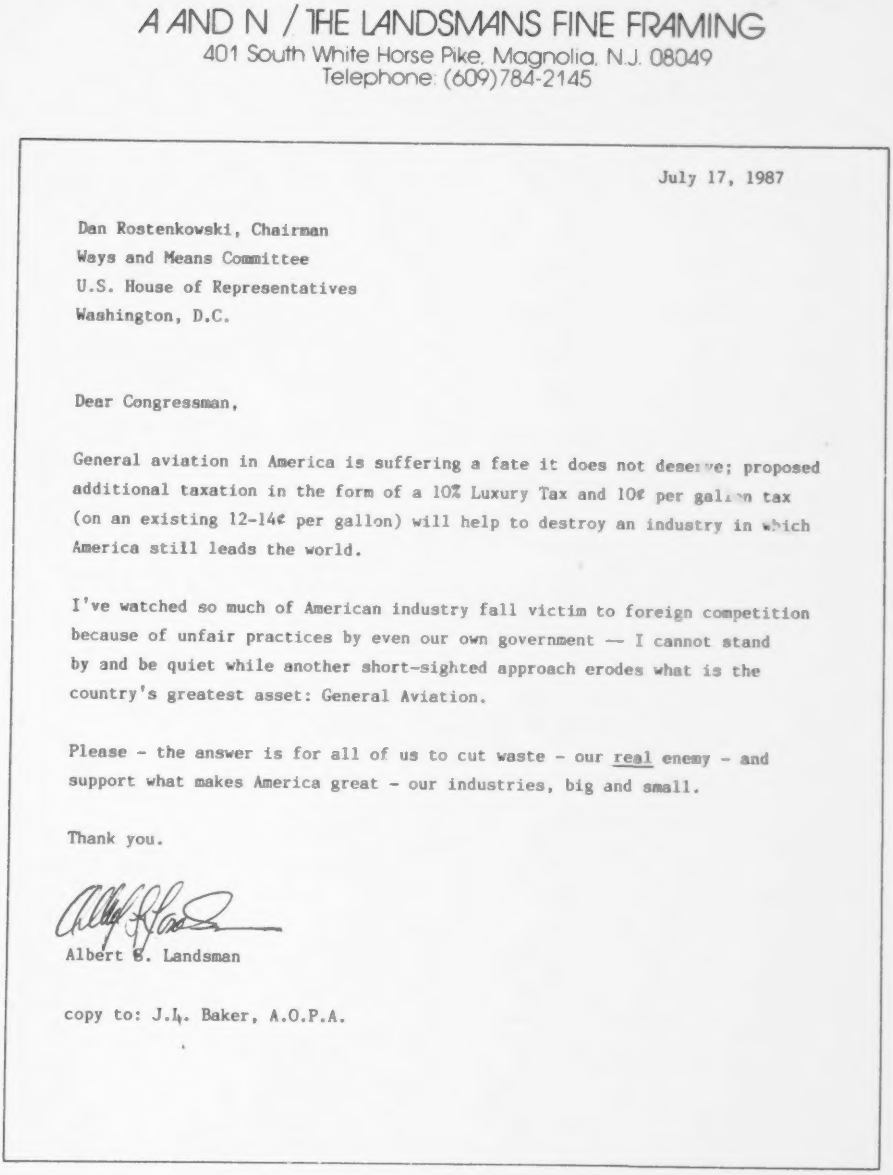
Howard L. Taylor, President
private pilot

Donna L. Taylor
Donna L. Taylor, Vice President
private pilot

Dana E. Taylor
Dana E. Taylor, private pilot

2525 Churn Creek Road - Redding, California 96001 - (916) 246-1200

LUXURY EXCISE TAXES - GENERAL AVIATION AIRCRAFT AND AVIATION FUEL



A AND N / THE LANDSMANS FINE FRAMING
401 South White Horse Pike, Magnolia, N.J. 08049
Telephone: (609)784-2145

July 17, 1987

Dan Rostenkowski, Chairman
Ways and Means Committee
U.S. House of Representatives
Washington, D.C.

Dear Congressman,

General aviation in America is suffering a fate it does not deserve; proposed additional taxation in the form of a 10% Luxury Tax and 10¢ per gallon tax (on an existing 12-14¢ per gallon) will help to destroy an industry in which America still leads the world.

I've watched so much of American industry fall victim to foreign competition because of unfair practices by even our own government — I cannot stand by and be quiet while another short-sighted approach erodes what is the country's greatest asset: General Aviation.

Please - the answer is for all of us to cut waste - our real enemy - and support what makes America great - our industries, big and small.

Thank you.

Albert S. Landsman

copy to: J.L. Baker, A.O.P.A.

AOPA
AIRCRAFT OWNERS & PILOTS ASSOCIATION
421 Aviation Way, Frederick Airport, Frederick, MD 21701, Telephone (301) 695-2000 Telex 89 [illegible]

STATEMENT OF JOHN L. BAKER

PRESIDENT

AIRCRAFT OWNERS AND PILOTS ASSOCIATION

On Federal Tax Revenue Options for 1987

COMMITTEE ON WAYS AND MEANS

U.S. HOUSE OF REPRESENTATIVES

JULY 14, 1987

Mr. Chairman, on behalf of the 260,000 pilot members of the Aircraft Owners and Pilots Association, I appreciate this opportunity to submit a statement regarding the aviation tax proposals contained in the Joint Committee on Taxation report, Description of Possible Options to Increase Revenues.

While we understand and appreciate the tough job this committee has in developing new revenues, increasing the federal tax burden on aviation at this time would be counterproductive to congressional revenue efforts and possibly lethal to American general aviation.

I would like to address three proposals of great concern to pilots: 1) imposition of a ten percent "luxury" sales tax on new general aviation aircraft; 2) addition of a ten-cent per gallon excise tax to aviation fuel; 3) increasing trust fund excise taxes by 33 percent. Each proposal individually has a negative impact on aviation, particularly the "luxury" tax. Taken together, the excise fuel tax proposals alone would increase general aviation's federal tax burden by a crushing 133 percent!

Aviation users are already paying twelve and fourteen cents per gallon into the federal Airport and Airway Trust Fund to support the capital development and modernization of the national airspace system. This totally user-supported fund consistently runs at a surplus with over $5 billion in unobligated funds anticipated at the end of this year. Increasing the excise tax levels in face of these massive trust fund surpluses is simply unfair and unconscionable.

The net effect of these revenue actions is to penalize both the aircraft ownership and operation of general aviation. The sales tax proposal will severely damage a uniquely American industry which is far from robust.

Once the world leader, the domestic general aviation industry has fallen on hard times, with only 1,495 new aircraft delivered in 1986, the fewest since World War II. In contrast, foreign manufacturers including France, Brazil, Great Britain, and Italy threaten to take over the American general aviation market.

The Joint Committee must recognize the basic contributions made by general aviation aircraft to national productivity and balance of trade. Only by maximizing the ability of American commerce to compete, both at home and abroad, will substantial progress be made to resolve the twin national dilemmas of the trade imbalance and federal deficit.

To the vast majority of aviation operators, an airplane is essential to business activities in much the same manner as the truck and automobile. These vehicles enable businesses to transport goods and personnel efficiently and conveniently to areas not covered by scheduled air transportation. Business uses of general aviation include air ambulance, reconnaissance, mapping and energy exploration, agricultural applications, mail and parcel delivery service, as well as flight training. Classifying general aviation aircraft as "luxury" items totally misrepresents the use and purpose of these airplanes.

Over the past seven-year period, general aviation flight activity has declined more than twenty percent. The number of pilots in this nation has been reduced by almost 120,000 pilots over the same period. Under today's de-regulated aviation industry, the demand for trained pilots has exploded. The Future Airline Professionals of America (FAPA) predicts that the commercial airline industry will need an additional 42,000 new airline pilots to meet the demand. The United States military, a traditional source of trained pilots for commercial airlines, is supplying fewer pilots to the civilian marketplace. Today more and more pilots are trained and gain experience through general aviation.

The additional burden imposed by more federal fuel taxes penalizes the use of general aviation, including necessary training operations. The fuel tax would add more expense to the already skyrocketing operations and aviation liability costs. This will ultimately result in depressing general aviation activity further, limiting the amount of federal revenues generated.

We respectfully request this committee to block these ill-conceived and counterproductive general aviation tax proposals.

##

ALEXANDER P. SCHREIBER, INC.
POST OFFICE BOX 2066
HAGERSTOWN, MARYLAND 21742
301 + 790-3977

July 16, 1987

The Honorable Dan Rostenkowski, Chairman
WAYS AND MEANS COMMITTEE
The House Office Building
Washington, D.C. 20515

Dear Chairman Rostenkowski:

I would urge you as Chairman of the Ways and Means Committee to DERAIL the ill conceived Federal tax proposal which would impose a 10 percent luxury tax on General Aviation aircraft and dictate an additional 10 cent per gallon aviation fuel tax on top of the existing 12 to 14 cents per gallon we are now paying.

Ours is a small corporation and we employ a light twin engine airplane strictly for business. We are one of thousands of small businesses located off major airways to make our business contacts with customers and suppliers who also are located off major airways. This means that in order to employ our time efficiently, we cannot spend 2 to 4 hours per trip driving to and from major airway terminals. Our light twin engine business airplane is invaluable to us.

Intelligent representatives of our way of life who are serving in Congress with you, must realize that the General Aviation is by far a business and not a luxury. Please listen to us and don't tax us out of existence.

Cordially,

ALEXANDER P. SCHREIBER, INC.

Alex Schreiber

sb

cc: John L. Baker, President AOPA

Aquarius Aviation, Inc.
11060 Paradela St.
Coral Gables, Fl. 33156-4244
16 July 1987

The Honorable Dan Rostenkowski
Chairman, House Ways and Means Committee
United States Congress
The Capitol
Washington, D.C. 20201

Re: Proposed General Aviation Luxury and Fuel Tax.

Dear Mr. Rostenkowski:

I was disturbed at the news relating the current proposal to tax General Aviation by the imposition of a 10% Luxury Tax on general aviation aircraft in addition to imposing an additional 10% Aviation Fuel Tax on top of the existing $.12 and $.14 per gallon.

The general aviation industry is all but moribund, due to many factors, but general agreement concludes that increasing costs to operators is primarily responsible. The assessment of additional taxes may serve as the single most regressive act that government could take against this most important resource.

The general aviation fleet is a fundamental tool to the business and transportation of the United States, however, manufacturers have pulled out of the market due to the escalating cost factors related to product liability, among others. This tax proposal would further stifle the production of this sector of industry and increase the costs of operators who by necessity use aviation as a practical means of transportation in the course of their business. A Luxury Tax imposed upon this sector is not only illogical, but probably would produce marginal revenue as compared to a tax on Yachts and Boats, for example.

I look forward to your consideration of these factors in the rejection of this tax proposal.

Sincerely,

J.W. Loewenherz

J.W. Loewenherz
President

Identical letter was received from the following:

Aquarius Aviation, Inc., C. B. Parks, Secretary, Coral Gables, Florida

103 Rachel Lane
Yorktown, VA 23692
July 15, 1987

Chairman Dan Rostenkowski
House Ways and Means
211 Rayburn House Office Building
Washington, DC 20515-1308

Dear Mr. Rostenkowski:

I must register my extreme concern about the proposed 10% Luxury Tax on the purchase of General Aviation aircraft and an additional 10¢ per gallon tax on aviation fuel.

The uninformed public views general aviation as a frivolity of the very rich. This could not be farther from the truth! Millions of miles are flown annually to deliver all manner of cargo, from "We'll-get-it-there-overnight" to electronics parts otherwise shipped by much slower train or truck; indeed, many industries locate near airports for just that convenience. Countless more miles are flown by business people who depend on small aircraft to reach wide-spread branches and clients, otherwise accessible only by long hours of highway travel.

True, many of us do use small aircraft for recreation, as do most boaters, but we also visit far-flung relatives and friends, and fly to interesting places we wouldn't have time to travel to by auto. But we represent only a tiny fraction of general aviation and most of us definitely are NOT rich. As such a private pilot, I rent 2 & 4 seat aircraft from nearby Patrick Henry Airport in Newport News, VA, supporting this interest with a part time job. My husband and 2 sons encourage my love of flying and enjoy taking trips with me. Most of my friends in the 99s, International Organization of Licensed Women Pilots, dedicated to air safety, are working women. We are all serious, careful pilots who love to fly; some make their living in aviation. All of us would be greatly hurt by these proposed taxes.

Very truly yours,
Joan L Brockett
Joan Brockett (Mrs. W.H.)

COMMITTEE ON
RECEIVED
JUL 2 [illegible]
WAYS AND MEANS

7/17/87

Dear Representative Rostenkowski —

I would like to protest in the strongest way possible the 10% Luxury tax and 10 cents more tax per gallon of fuel.

My small private aircraft is used in business and small business is already over taxed. —

Please vote against this unfair and unequal tax

Best regards

Cam L Fannin

1810 - 50th St. • Lubbock, Texas 79412 • 747-4422
CAM FANNIN INSURANCE AGENCY, INC.

Everything i am i owe to chocolate

PALISADES [illegible]

Saturday, July 18, 1987

Chairman Dan Rostenkowski:

Dear Sir: Please help to block the proposal to impose a 10% luxury tax and a ten cent per gallon aviation fuel tax on top of the existing fuel tax.

Such taxes will make it all the harder for small business such as ours to use our airplane to make the most efficient use of time to get to our customers.

Travel in other ways will get me to do my work not only on Saturdays, but Sundays as well..

Thanks William F. Carver
Vice President

D. A. CLARKE
1461 EAST GLENOAKS BOULEVARD
GLENDALE, CALIFORNIA 91206

July 17, 1987

The Honorable Dan Rostenkowski
Chairman, Ways and Means Committee
United States House of Representatives
Washington, D.C. 20515

Dear Chairman Rostenkowski:

It is my understanding that a proposal will come before the House Ways and Means Committee for additional taxes on General Aviation. I refer to the proposed 10% luxury tax (luxury tax! sounds like Ann Landers) plus an additional 10¢ per gallon on aviation fuel--this on top of the 26¢ now being paid.

General Aviation serves a large segment of the United States Commerce--freight--passengers for hire, including people like yourselves.

You must be aware of the current state of depression in General Aircraft manufacturing and sales in this country. Virtually no single engine aircraft are being manufactured corporately--few piston engined twins either. Offshore manufacturers selling in this country appear to be doing quite well.

Additional taxes, luxury or otherwise, on aircraft or aviation fuel is another nail in the coffin of General Aviation.

Please vote in opposition to ANY proposal to increase taxes or add new taxes on General Aircraft or aviation fuel.

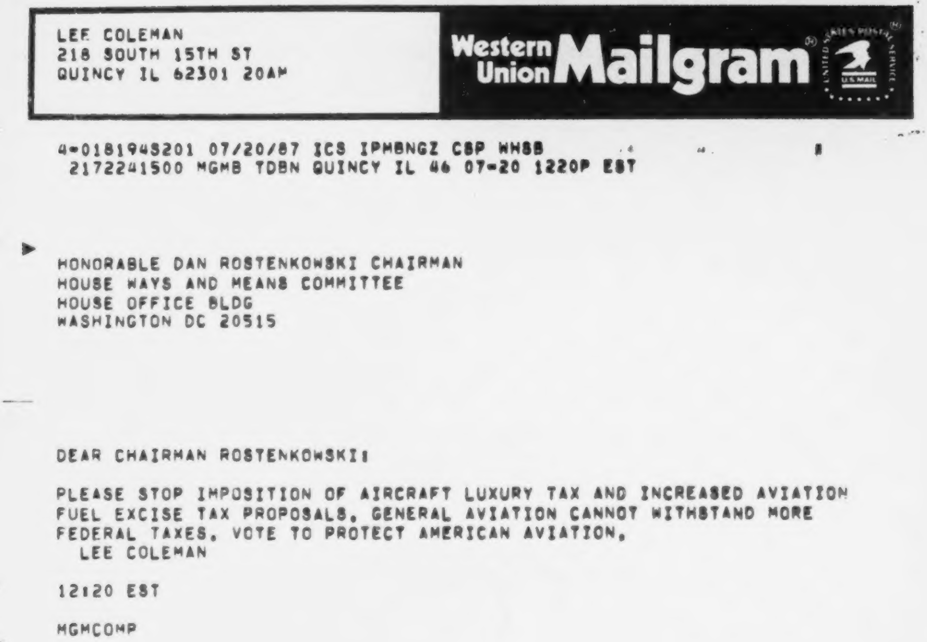
Very truly yours,

D. A. Clarke
Private Pilot

DAC/bg

letters to:
- House Ways and Means Committee Members
- Senator Pete Wilson
- Senator Alan Cranston
- Congressman Carlos Moorhead

cc: John L. Baker, President A.O.P.A.



LEE COLEMAN
218 SOUTH 15TH ST
QUINCY IL 62301 20AM

Western Union Mailgram

4-0181945201 07/20/87 ICS IPMBNGZ CSP WHSB
2172241500 MGMB TDBN QUINCY IL 46 07-20 1220P EST

HONORABLE DAN ROSTENKOWSKI CHAIRMAN
HOUSE WAYS AND MEANS COMMITTEE
HOUSE OFFICE BLDG
WASHINGTON DC 20515

DEAR CHAIRMAN ROSTENKOWSKI:

PLEASE STOP IMPOSITION OF AIRCRAFT LUXURY TAX AND INCREASED AVIATION FUEL EXCISE TAX PROPOSALS. GENERAL AVIATION CANNOT WITHSTAND MORE FEDERAL TAXES. VOTE TO PROTECT AMERICAN AVIATION.
LEE COLEMAN

12:20 EST

MGMCOMP

Similar Mailgrams were received from the following:

Dennis English, Coal Valley, Illinois
International Eye Care Center, John H. McDougall, Quincy, Illinois
Jon Fey, Inc., Jon Fey, Berwyn, Illinois
William McReynolds, M.D., Quincy, Illinois
S and K Air Power Corp., James Gillespie, Granville, Illinois
Trendco Midwest, Inc., RPV, Robert Paul Vetzel, Wheeling, Illinois

July 17, 1987

Hon. Dan Rostenkowski, Chairman
House Ways and Means Committee
RHOB
Washington, DC

Dear Congressman Rostenkowski:

I should like to inform you and the Committee of my vehement opposition to the proposal from the Joint Committee on Taxation to further tax the "luxuries" of general aviation by way of a tariff on new general aviation aircraft, additional tax on aviation fuel, and the per centage increase on taxes to the Airport and Airway Trust Fund.

To attempt to further jeopardize an industry which has been so cruelly slighted already by lawyer's manipulative games of product liability, excessive regulation at the hands of a politically-crazed DOT Secretary, and yet continues to contribute so much to the slacking economy of an ungrateful nation, by providing a medium for the transportation of goods and services, medical care, flight training for an aviation system already savaged by a pilot shortage, is an absolute abomination and absolutely unconscionable.

I respectfully submit to you and the committee to strike this proposal as a poorly and ill-conceived attempt to undermine a vital section of the American economy, and take a good, long look at what general aviation does for this country. The consequences of such a bill would prove catastrophic and the effects would be far more than a ripple throughout the very core of this nation.

Hopefully,

Gary E. Crump
Box 3794
Frederick, MD 21701

Davenport Realty Trust
20 NORTH MAIN STREET
SOUTH YARMOUTH, MASS. 02664
617-398-2293

TRUSTEES
JOHN K. DAVENPORT
PALMER DAVENPORT
DeWITT P. DAVENPORT

July 17, 1987

Chairman Daniel Rostenkowski
Ways & Means Committee
U.S. Senate
Washington, D.C. 20000

RE: Aircraft Additional Taxes

Dear Sir:

Our aircraft, a ten-year old Baron, is flown on business to locations not accessable by airlines.

We consider it unfair to nail us with another 10¢/gallon tax on fuel and a luxury tax on a business tool. This is not a toy nor hobby; it is a tool of our business.

Why not lay off the aircraft business that is on its back due to the liability insurance crisis.

Go after the illegal, and legal for that matter, investment bankers or someone who can pay.

Very truly yours,
DAVENPORT REALTY TRUST

Palmer Davenport

Palmer Davenport
Trustee

PD/chl

Affiliates: Davenport Building Co., Intercity Alarms, Cape Cod Fence Co., The Mortgage Co., Red Jacket Inns, Blue Rock Golf Club, Yarmouth Shopping Plaza, Cape Cod Mall, Cape & Islands Telephone

Six Pine Street
Maynard, Massachusetts 01754

July 17, 1987

The Honorable Dan Rostenkowski
Ways and Means Chairman
House Office Building
Washington, D.C. 20515

Dear Congressman Atkins:

I would like to urge you to block the imposition of additional taxes on aviation fuel and of luxury taxes on general aviation aircraft. General aviation is being hit hard because of changes in the market; additional taxes will result in increasing losses by American general aviation manufacturers.

I am an owner of a general aviation aircraft. It was seven years old when I purchased it. I am a middle class wage earner, and I paid significantly less for my aircraft than many people do for sail and power boats. I paid almost $1800.00 sales tax to the Commonwealth of Massachusetts when I made my purchase. I pay state and federal taxes on fuel.

Most owners of light aircraft are not wealthy. We have five to ten year payments to make, and we don't take vacations to allow us to own an aircraft. Adding a 10 percent luxury tax will make it impossible for the average aircraft owner to keep his or her airplane. The American general aviation business is in serious trouble. As a result of economic downturns and increased cost of liability insurance, lower cost training aircraft are no longer being manufactured in this country. It is even getting difficult to find parts. Please don't deliver a final blow to general aviation.

Sincerely,

Anne Marie C. Desmarais

Anne Marie C. Desmarais

Don Chapman Consultants, Inc.

3180 Airport Way
Boise, Idaho 83705
(208) 383-3401

July 17, 1987

Dan Rostenkowski, Chairman
House Ways & Means Committee
House Office Bldg.
1102 Longworth
Washington D.C. 20515-6348

Dear Mr. Chairman,

Please oppose the proposed Ways and Means Committee measure for a luxury tax of 10%, and a 10% aviation fuel tax, on general aviation aircraft. My business aviation use is important to my company and is 99% for work, not for luxury.

I would appreciate any effort you can make to defeat this ill advised proposal, as the general aviation industry is already in straitened circumstances and needs no additional burdens in terms of taxes. There is always a tendency to consider aviation use as frivolous, when it is often usually anything but that--for those of us who use aircraft for business purposes.

Thank you very much for your consideration.

Sincerely,

Donald W. Chapman/cg

Donald W. Chapman
Don Chapman Consultants
3180 Airport Way
Boise, Idaho 83705

cc: Larry Craig

4426 Cobalt Dr.
Harwood, Md. 20776
July 18, 1987

Dear Mr. Rostenkowski:

I am writing to express my strong opposition to the proposed assessment of a 10% luxury tax on all general aviation aircraft and to the additional tax of 10 cents per gallon on aviation fuel.

My aircraft is anything but a luxury. It serves as an economical mode of transportation that enables me to reach cities which are not served by commercial airlines.

The power to tax is the power to destroy. Please do not impose these crushing taxes which will do further immeasurable harm to the general aviation industry and to those of us who use this fundamental mode of transportation.

Sincerely yours,
Richard [illegible]

July 27, 1987

850 Shady Hollow Circle
Bloomfield Hills, Michigan 48013

Mr. Dan Rosenkowski
Chairman, Ways & Means Committee
U. S. Congress
Washington, D.C.

Subject: General Aviation Tax

Dear Mr. Rosenkowski:

I am involved in owning and flying my own General Aviation airplane and am opposed to any additional taxes either on fuel or new aircraft. These taxes would be an extreme hardship for the owner-operators.

As you know, General Aviation is in trouble because of high costs. Taxes of this type would further set the industry back.

Sincerely,

Walter R. Ebling

Walter R. Ebling

32 Canterbury Drive
Pennsville, NJ 08070
17 July 1987

Rep. Dan Rostenkowski
House Ways & Means Committee

Dear Rep. Rostenkowski:

I am writing to express my opposition to the proposals for luxury taxes on General Aviation equipment and fuel.

General Aviation is not a luxury. It is a means of transportation - an alternative to the scheduled airline corporations. Given the present state of airline "service" - and especially the reports of airline pilot error that appear almost daily in the news - we need an alternative.

General Aviation is also jobs - manufacturing and service. Although General Aviation is still reeling from economic downturns, it provides thousands of jobs in every state of the Union. Eliminating jobs via additional taxes would badly hurt those put out of work, and would probably not raise much money.

As for the recreation part of General Aviation - if you will be at home in your district during the first week of August, I strongly urge you to spend a day at the Experimental Aircraft Association annual meeting at Oshkosh, WI. I am sure that the leaders of EAA will make you most welcome, and you will have the opportunity to meet many ordinary "non-luxury" working people who have made General Aviation a part of their lives.

Thank you for your consideration!

Sincerely,

John M. Eby

John M. Eby

FLIGHTCRAFT
PORTLAND · SEATTLE · SPOKANE · EUGENE
COMPLETE AIRCRAFT SALES, PARTS, MAINTENANCE AND CHARTER SINCE 1948

COMMITTEE ON
[illegible]
AUG 18 1987
[illegible]
WAYS AND MEANS

August 6, 1987

The Honorable Dan Rostenkowski
2111 Rayburn House
Washington, D.C. 20515-1308

Dear Mr. Rostenkowski:

The Congressional Joint Committee on Taxation has released revenue raising recommendations that propose a 10% "luxury" tax on the purchase of all non-commercial aircraft and as many as three possible increases in taxation on aviation fuel.

With all due respect sir, enough is enough!!

Our industry is about to vanish largely due to perplexing changes in the tax laws such as the imposition of "empty-seat" tax charges, the loss of the I.T.C., and more stringent depreciation rules. As a result, aircraft unit deliveries have dropped from over 17,000 in 1979 to less than 1,400 in 1986. 1987's estimate is 800 units. Literally tens of thousands of employees have lost their jobs.

Those of our businesses that have survived are doing so because of innovation, diversification, and just plain courage. But these latest proposals promise to be the final, death blow. Any taxes projected to be raised by this maneuver are illusory, since the industry would fade away completely shortly after the imposition of such a tax.

General Aviation aircraft are not a luxury. They provide the nation's economy with the efficient, fast and effective transportation that is essential to the flow of commerce throughout the nation and the world. The people who use business aviation are the pivot points around which revolve much of the nation's economy. Many jobs depend upon their ability to be where the action is and be where decisions must be made. No other form of transportation or communication provides that capability with greater effectiveness or with greater conservation of time and human resources.

Please take the actions necessary to prevent the 10% luxury tax on aircraft and increases in aviation fuel taxes from becoming law and further stifling an important segment of our nation's economy.

Sincerely,

Dan Bacheldor
Director of Operations Eugene

FLIGHTCRAFT INC. • PORTLAND INTERNATIONAL AIRPORT
7505 NORTHEAST AIRPORT WAY • PORTLAND, OREGON 97218 • 503-281-3300
A PAPE BROS. INC. COMPANY

Beechcraft

Identical letters were received from the following, all employees of Flightcraft, Portland, Oregon:

Mr. Jay Bradshaw, Chief Pilot, Eugene
Ms. Billie Dutcher, Director of Customer Services
Mr. Rich Fenberg
Mr. Kerry Glass, Director - Avionics
Mr. Tom Good, General Manager of Flightcraft, Eugene
Mr. Alan Roberts, Vice President/General Manager

3007 Valorie Lane
Midland, Michigan 48640
July 22, 1987

The Honorable Dan Rostenkowski
Chairman
House Ways and Means Committee
United States House of Representatives
Washington, D.C.

Dear Mr. Rostenkowski,

I am a pilot of twenty four years, presently employed by a Fortune 500 Corporation. At our home base in Saginaw, Michigan, we operate five airplanes, airplanes which fly almost every day doing things for us that the airlines just cannot match.

As a working pilot, I would like to comment on a proposal I understand is in your committee now.

The first part has to do with a 10% tax on all new general aviation airplanes being produced today.

The general aviation industry in the United States is in its worst straits since just after WW II. This years production will be at a 40 year low. To tax an industry already on the ropes doesn't seem to me to be in the best interest of this country.

I understand that a 10 cent per gallon tax on aviation fuel has been proposed. Again, this seems to me to be a slap in the face to an industry in trouble. I am opposed to any new taxes on aviation fuel.

Thirdly, I have been informed that a proposal has been made to tax at greater than 30% all monies earmarked for the Aviation Trust Fund. This seems to me to pose a problem too, as we in aviation have been trying for years to get money out of that fund to increase safety.

Many times pilots in our department must contend with runways that are too short, no precision approaches in place where we fly, and lighting systems which are sub par. I feel that in many cases these obvious safety problems could be remedied by releasing ADAP monies, rather than to holding on to them. And now, hearing of a proposal to tax these funds before they even get to the bank raises my blood pressure.

I beg you and your committee to reconsider all three of these proposals before they take bill form, and to either lessen their impact or eliminate them altogether.

Thank you for your attention.

Sincerely,

Andrew Foster
Andrew L. Foster
ATP, B.S., M.A.

11308 Stony Creek Rd
Milan, MI 48160
July 15, 1987

Dear Mr. Rostenkowski,

I am writing to oppose the proposed 10% luxury tax on general aviation aircraft and to oppose an additional 10¢ per gallon aviation fuel tax on top of the already too high aviation fuel tax.

This is an ill-conceived idea & the proposal should be defeated. There are already too many taxes levied.

Sincerely

Patricia Hooley

11308 Stony Creek Road
Milan, MI 48160
July 15, 1987

Honorable Daniel Rostenkowski
Chairman, House Ways and Means Committee
U. S. House of Representatives
Washington, D. C. 20515

Dear Mr. Rostenkowski:

I oppose the idea of a ten percent luxury tax on general aviation aircraft and an additional ten cent per gallon aviation fuel tax. The Aviation Trust Fund was set up and funded through taxes on aviation users to cover aviation needs. There is a surplus in the fund and, therefore, no added taxes are needed.

This tax proposal penalizes the general aviation aircraft industry at a time when it is dying. We were once leaders in the aviation industry, now we are followers. The general aviation industry needs help to recover--not added taxes to kill it altogether.

The proposal for added taxes on general aviation aircraft and on aviation fuel should be soundly defeated.

Sincerely,

Steven Hooley

Steven Hooley

July 16, 1987

Congressman Rostenkowski:

On July 20th, please vote "NO" on the federal tax proposal seeking a 10-percent luxury tax on general aviation aircraft and add ten cents per gallon to the existing aviation fuel taxes of twelve and fourteen cents a gallon.

General aviation (flying small, single- or twin-engined planes like Cessnas, Pipers, and Beechcraft) is NOT a luxury, but a useful, fundamental tool. Most of the pilots flying today learned how in these small aircraft.

Businesses use these aircraft to schedule meetings and keep appointments which would be missed if they flew the delay-prone commercial airlines.

Besides, these new measures would only increase the cost of flying. And as a student pilot on a tight budget, I'm opposed to that.

So please block these proposals when they come up for a vote. Vote "NO" on them, and keep general aviation's costs down.

Thank you for your time and attention,

William R. Jorns

WILLIAM R. JORNS
554 Rex BLVD.
Elmhurst, IL. 60126

Robert G. Kroll, D.D.S.
90 Cedar Street
Millburn, NJ 07041

July 16, 1987

Representative Daniel Rostenkowski, Chairman
Ways and Means Committee
House Office Building
Washington, D.C.

Dear Representative Rostenkowski:

I am writing to express my disappointment about the proposed 10 % luxury tax on general aviation aircraft and the additional 10 cents per gallon tax on aviation fuel. General aviation is no more a luxury than is the automotive or other components of our transportation system. Yet, because our voice is small, we are subjected to many discriminatory and often senseless penalties under the guise of misleading slogans.

We are already paying close to $2.00 per gallon for fuel which includes moneys designated by Congress for airport development and safety. There are already billions of dollars in this fund that have not been used, and I see no fairness in exacting more money from aircraft users which can only be of detriment to them personally and serve no useful public purpose.

It is short-sighted not to see the contributions of general aviation to the overall economy. It is tragic to compromise safety by discouraging pilots from maintaining their proficiency in flight by increasing the economic barriers that already exist.

Very truly,

Robert G. Kroll, DDS

Robert G. Kroll, D.D.S.

ST. JOHN NEUMANN NURSING HOME

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July 16, 1987

Chairman Dan Rostenkowski
The Capitol
Washington, D.C. 20515

Dear Chairman Rostenkowski:

It has been suggested to me that it would be helpful to the continued viability of United States General Aviation activity if I would present to you my request that you oppose the new proposal to tax aircraft as luxury items and to further raise the already high fuel tax on aviation gasoline.

Over twenty-five years ago, my recently deceased Mother purchased a used aircraft for family purposes. I continue to operate this airplane, a Mooney M20-C. It has made possible family contacts over many years that would otherwise have been impossible. My four sisters and my brother live in four different states and in the District of Columbia. (As a matter of fact, my sister Mimi is a neighbor of yours at the Capitol, in the office of Congressman Foley. The only visits I have been able to make to see Mimi in the last ten years have been made in the Mooney.)

In the history of American aviation, we have never seen a period of such economic depression. While government taxes are not the only contributing cause to this situation, increased taxation at this time will certainly not promote the welfare of this vital part of our transportation system.

Your kind consideration of my request is deeply appreciated.

Cordially,

Rev. Leo J. McGee
10400 Roosevelt Blvd.
Philadelphia, Pa. 19116

10 Grouse Road
Malvern, PA 19355
July 20, 1987

Congressman Dan Rostenkowski
House Ways and Means Committee
Rayburn House Office Building
Washington, DC 20515

Dear Congressman Rostenkowski

It is with great apprehension that I note the House Ways and Means Committee is about to act on a federal tax proposal which would impose a 10 percent luxury tax on general aviation aircraft and dictate an additional 10 cents per gallon on aviation fuel. As a person would earns his livelyhood in aviation, I have witnessed the industry fall on its knees in the past ten years. Aircraft production which was once a stronghold of US export has all but stopped. Aircraft production has been forced out of our state of Pennsylvania. The uncontrolled problem of product liability insurance cost has left the industry on the endangered list. Now it faces taxing measures that appear to treat the industry as one that should be discourged. Is this yet another industry that we are egar to turn over to the Japanese?

Aviation is an important arm in our transportation industry as well as being one of the things we as a nation did well. The numbers of taxable units or gallons of fuel is quite small and would create more loss than gain in taxable dollars. There are about 220,000 aircraft in the United State or about the same as the number of automobiles as one would find in Chester County where I live. This small number provides the backbone of a transportation network that serves the smaller towns and cities at a time when the major airlines have abandon these areas. To tax these vehicles as a luxury is a certain way to insure that aircraft transporation will surely become the transport that only the rich can afford. This is the way it is handled in most other countries.

Aviation pays its taxes as does all business. What is the justification for singling it out for the extra tax?

I respectfully urge you to vote against such legislation that penalizes general aviation at a time when aviation is fighting for its life.

Sincerely yours,

John Mignone

John Mignone

230 Old County Rd.
Lincoln, MA 01773

July 15, 1987

Dear Chairman Rostenkowski:

I am writing to you regarding the proposed new taxes to be applied to aviation fuel as well as to aircraft itself. As a private pilot and as a citizen I oppose these taxes.

As a private pilot, I oppose them because the gas tax is not used to benefit all of the people who are taxed. The government already has a fund presumably for the benefit of aviation, and it often is used for other purposes besides aviation. Even when used for aviation, most of the expenditures go for improvements that benefit the corporate operators and the commercial air carriers, rather than benefit the private pilots; this always has been the case. I expect that this proposed tax also will produce revenue that will be used for purposes other than aviation and when used for aviation, used for the benefit of these other operators.

As a citizen, I object to new taxes being levied soon after the income tax revision. The tax revision is aimed at being more fair and eliminating the tax deductions used by people who can afford such deductions. To follow this up by proposing a "luxury tax" is quite unfair.

I urge the Ways and Means Committee to defeat these discriminatory proposals.

Cordially yours,

Norbett L. Mintz, Ph.D.

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815-625-5954

August 12, 1987

The Honorable Dan Rostenkowski
2111 Rayburn House Office Building
Washington, DC 20515

Reference: General Aviation Taxation

Dear Mr. Rostenkowski:

First, I wish to congratulate you for your efforts in tax reduction and simplification and balancing the budget. Recognizing that these have not really been achieved, you personally and through your efforts have pointed the direction and with continued emphasis, I am sure can achieve these very necessary goals for the American people.

I am not sure how you stand on the 10% "Luxury" tax on general aviation aircraft and the additional ten cents per gallon on aviation fuel on top of an existing 12 and 14 cents per gallon, but these taxes are grossly unfair and will help further depress if not kill the general aviation industry necessary for many small businessmen and communities.

The aviation tax fund is already bulging with billions of dollars of uncommitted funds for airway, air traffic control facilities, reliever airports, and the many necessary improvements to public airports serving small and medium size communities.

These funds are wrongly shown added to the general fund to reduce the deficit. These funds were contributed through air travel by taxes on commercial carriers and many of the billions of dollars by general aviation use through the fuel tax.

They are not intended to pay salaries or normal operating expenses of the FAA.

This system was patterned after the automotive taxes and road system which works much better because it is not administered by a self serving bureaucratic Federal Aviation Administration or equivalent road commission.

The Federal Aviation Administration like many federal agencies is reluctant to admit that they are wrong and suffers from chronic "not invented here" itis.

The microwave landing system, a worthless poorly concocted technical nightmare, is a prime example of the reluctance of the agency to admit any wrong decision and change it.

The instrument landing presently in use with recent solid state advances is completely adequate for safe conduct of instrument approaches at all airports under all conditions that the using aircraft are certified to function.

A second example is the unwise decision to reduce and consolidate the number of flight service stations ahead of replacement with a satisfactory weather and pilot briefing system.

The personnel that fly the commercial aircraft as captains and second officers have to learn to fly somewhere and the military, while a source for many trained pilots, is not capable of supplying the total needs of the industry. This training must come through use of general aviation aircraft small fixed base operators throughout the country who can afford to purchase and maintain single engine general aviation aircraft. This use is certainly not a luxury.

In my business, most of my sales are made within a radius of 500 miles of our factory, and we use a small single engine aircraft to provide the travel between our office which is 130 miles from a suitable commercial airport (O'Hare in Chicago) and our customers offices in Michigan, Wisconsin, Kansas, Nebraska, Kentucky, New Jersey, and the Carolinas. Trips that would take me at least two days using commercial aviation can be made round trip in a single day at great saving in time and cost while providing excellent service to our customers by use of this small aircraft. The aircraft is as much a tool to our business as is our fork lift truck.

If I had to pay an additional ten cents a gallon for aviation fuel and ten percent surtax on equipment and replacement aircraft when the time comes, this indeed might spell the end of our business.

General aviation is not the luxury most people and certainly the press think it is. A weekday visit to your local general aviation reliever airport and survey of the traffic into and out of that airport through a one month period will show you that fully 90% of the operations are commercial or training in nature with less than 10% being classed as luxury personal recreational flying.

An additional or excise tax on boats and truly recreational products would serve to bring in considerable more income and would probably not require the 10% added tax proposed on general aviation products.

Please reconsider your position if you are in favor of this added burden on our industry and if you are not in favor of the tax, please use your effort, position, and intelligence to help defeat these unfair added taxes.

Sincerely yours,

A. Mueller
President

NATIONWIDE
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HOME OFFICE ONE NATIONWIDE PLAZA • COLUMBUS OHIO 43216

Ways and Means Chairman Rostenkowski July 17, 1987
United States Congress
Washington, D.C.

Dear Dan,

I am writing to you about something that is of great concern to our family. I am a private pilot and I fly occassionally with my wife Kathy. It is a nice way to spend time together, it is a nice way to release stress and relax. But what I just heard about Congress's possible intentions is causing me great stress. It is absolutely crazy to put a 10% luxury tax on aviation fuel and dictate an additional 10 cent per gallon tax on top of the existing 12 and 14 cents per gallon we have now.

What this does Dan, is continues to tax the middle class voters AGAIN. Can we not get away from the idea of TAX, TAX, and TAX. Please as my Senator please vote against this horrible tax on July 20th.

Just a reminder, GENERAL AVIATION IS NOT A LUXURY BUT A FUNDAMENTAL TOOL.

Sincerely,

[illegible] and Kathy Mohan

Mr. and Mrs. Robert A. Mohan

LIONEL SAWYER & COLLINS
ATTORNEYS AT LAW
1700 VALLEY BANK PLAZA
300 SOUTH FOURTH STREET
LAS VEGAS, NEVADA 89101
(702) 383-8888

FAX (702) 383-8845 (GROUP III)
FAX (702) 383-8852 (GROUP I & II XEROX 485)

STEVE MORRIS

WRITER'S DIRECT DIAL NUMBER:
(702) 383-8821

July 20, 1987

The Honorable Dan Rostenkowski
Ways and Means Chairman
United States Congressman
United States House of Representatives
Washington, D.C. 20515

Dear Chairman Rostenkowski:

I urge you to reject the proposal to impose a 10 percent luxury tax on general aviation aricraft and an additional 10 cents per gallon aviation fuel tax on aviation gas. General aviation is not a wasteful luxury. For many it is a legitimate and primary means of travel, for both pleasure and business. Certainly that is true for me; I use my small plane a great deal in my business as a lawyer and as a traveler. General aviation has not been treated equitably in the disbursement of revenues generated by the current aviation fuel tax. It would be most unfair to compound this inequity by adding to those taxes revenues generated by more taxes.

Please leave things as they are with respect to general aviation. It is already on the ropes.

Very truly yours,

Steve Morris
STEVE MORRIS

SM:jbp

RENO OFFICE 1100 VALLEY BANK PLAZA, 50 WEST LIBERTY STREET · POST OFFICE BOX 2610 · RENO, NEVADA 89505
(702) 788-8666 · FAX (702) 788-8682 (GROUP III) · FAX (702) 788-8681 (GROUP I & II XEROX 485)

NATA
Founded
December 28, 1940

NATIONAL AIR TRANSPORTATION ASSOCIATION
4226 King Street • Alexandria, Virginia 22302 • (703) 845-9000

July 22,1987

The Honorable Dan Rostenkowski
Chairman
House Ways and Means Committee
1102 Longworth House Office Bldg.
Washington, DC 20515

Re: FY88 REVENUE OPTIONS

Dear Mr. Rostenkowski:

The National Air Transportation Association represents the business interests of fixed base operators and air taxi companies at over 1,200 locations throughout the United States. Most fixed base operators or FBOs provide a variety of aviation services including: sale of aviation fuel to business and private aircraft; airline refueling; new and used aircraft sales; aircraft charter; flight instruction; aircraft parking and hangaring; and aircraft maintenance.

Even though most FBOs provide all of these services, the major profit centers are fuel sales, aircraft charter and, until recently, aircraft sales. Any tax proposals increasing the cost of these activities will severally damage an already fragile aviation economy.

There are four different tax options included in the Joint Committee's *Description Of Possible Options To Increase Revenues Prepared For The Committee On Ways And Means* which directly affect NATA member companies. These are:

Imposing a ten percent "luxury" tax on sales of new non-commercial aircraft;

Increasing the Federal excise tax on aviation by five to ten cents per gallon;

Raising the current eight percent transportation of persons tax (ticket tax) to ten percent, and increasing (no amount specified) the three dollar international departure tax and the five percent air cargo tax (cargo waybill tax);

Increasing by thirty-three percent, all excise taxes used to support special funds (i.e., Aviation Trust Fund).

Our members are extremely concerned with the negative impact a "luxury" tax *would have on already depressed aircraft* sales and are strongly opposed to the aviation excise tax increases recommended in the Joint Committee report. It is incomprehensible that aviation would be asked to pay more excise taxes when the Aviation Trust Fund has a $5 billion surplus which is already being used to reduce excessive budget deficits, rather than being spent on aviation development as originally intended.

The proposed "luxury" tax on non-commercial aircraft totally ignores the real purpose and use of general aviation aircraft as business tools. These aircraft provide the flexibility to maximize time and resources and contribute to overall efficiency. General aviation aircraft are also vitally important to the economic viability of non-urban areas not adequately served by air service. According to the Federal Aviation Administration, only 705 of the nation's 16,319 landing facilities are served by air carriers.

Enacting the "luxury" tax could mean the end of general aviation aircraft production in this country. The United States once led the world in general aviation aircraft production but has now fallen on hard times, delivering only 1,495 new aircraft in 1986 compared to the 17,811 delivered in 1978. While production has been decreasing in the U.S., various foreign manufacturers have been increasing production and their corresponding share of the world market.

We urge this Committee to acknowledge the essential function of general aviation aircraft as providers of necessary transportation and protect the once-vibrant manufacturing industry by rejecting the "luxury" tax on aircraft.

The list of revenue options contains three different proposals which would raise aviation excise taxes. In all three cases the recommendations ignore the original intent of aviation user taxes: to provide the financing for capital improvements of the nation's airports and upgrade the FAA's air traffic control system. In 1982 the use of the Aviation Trust Fund was expanded to financing a major portion of FAA's operations.

We understand the pressures to reduce the huge budget deficits, and we support the concept of restoring the fiscal health of this country's government. Aviation users have long accepted paying for improvements to the aviation infrastructure. However, NATA Member companies strongly oppose the tactic of using the Aviation Trust Fund to offset the deficit. It is even more troubling that this is being proposed at a time when modernization of the air traffic control system is in a vital aquisition stage and public pressure to improve the system and reduce delays is at an all-time high.

FBO and air taxi companies serve as the aviation excise tax collectors for general aviation. Currently, retail sales of aviation gasoline are subject to a 12.1 cents per gallon tax and jet fuel a 14.1 cents per gallon tax. Providers of air transportation must charge customers either an eight percent "ticket" tax for passengers, a five percent cargo way bill tax for cargo or a three dollar per person tax for international flights. Increasing any of these taxes would have serious implications on our members cost of doing business. In many cases general aviation is also taxed at the state level. It would be unfair to make general aviation pay additional taxes when the industry is already paying more than its fair share.

As you may be aware, the 1982 Airport Improvement Act expires at the end of FY87 and the taxes used to support aviation programs expire at the end of CY87. When this Committee considers reauthorizing the taxes, NATA strongly encourages retaining the current tax rates. With the current surplus in the Aviation Trust Fund and the past inability to spend the money, some type of tax reduction "trigger" mechanism should also be included. This has been recommended by the House Public Works Committee and endorsed by Senator Wendall Ford, Chairman of the Senate Aviation Subcommittee. Increasing aviation taxes would ignore the significant contributions made to the economy by the flying public and the aviation industry.

In conclusion, NATA member companies are unequivocally opposed to the ten percent "luxury" tax on aircraft and any increases of the aviation excise taxes. The revenues to be gained by the aviation tax proposals are insignificant when compared to the totals required and the economic damage which would result.

On behalf of our member companies, we appreciate the opportunity to submit our views. We will be happy to respond to any question you may have.

Sincerely,

Lawrence L. Burian

Lawrence L. Burian
President

STATEMENT

OF THE

NATIONAL BUSINESS AIRCRAFT ASSOCIATION, INC.

Mr. Chairman and Members of the Committee:

Thank you for allowing the National Business Aircraft Association, Inc. (NBAA), to submit this statement. The NBAA represents the aviation interests of American business. Our 2900 member companies, operating some 5500 aircraft, depend on aviation to help them meet their daily business transportation needs. Any proposal which would result in increased taxes on business aircraft operators is of great concern to us and must be closely examined to determine its effect on the ability of American business to continue to use their aircraft in a reliable, safe and efficient manner. Unfortunately, the proposals presented to this Committee fail these tests miserably.

Consequently, we must express our strong opposition to proposals found in the Description of Possible Options to Increase Revenues (the Options), prepared by the Joint Committee on Taxation and submitted to you on June 25. That document describes the various options available to this Committee as it sets about to craft legislation increasing revenues by $19.3 billion in Fiscal Year 1988 and $64.3 billion through the three years ending with FY 1990.

The Options include proposals which, if enacted, would bring great harm to general and business aviation aircraft users, manufacturers and suppliers and which we must oppose. Specifically, we oppose those proposals which would:

1. Impose a ten percent "luxury" tax on general aviation aircraft;
2. Increase by five or ten cents per gallon the Federal excise tax imposed on aviation fuel as part of the Leaking Underground Storage Trust Fund (LUST) tax base;
3. Increase the current eight percent excise tax on transportation of persons by air to ten percent; and
4. Increase by 33 percent the excise taxes deposited into trust or special

funds to offset "implicit contributions" to those funds and by an additional amount equivalent to the supposed revenue loss from revenue bonds used to finance related activities.

Allow us to discuss these tax proposals and their impact on business aviation in some detail.

"LUXURY" TAXES ON GENERAL AVIATION AIRCRAFT

Perhaps the most onerous and ill-conceived proposal found in the Options is that which would impose a "luxury" tax on aircraft not used for the commercial transportation of passengers or cargo. This proposal suffers from several misconceptions, not the least of which is the mere hint of general aviation aircraft being "luxuries."

For the vast majority of general aviation operators, their aircraft are essential to their business activities, directly comparable in utility to computers, machine tools, warehouses and delivery trucks. They are used for the everyday transportation of employees, salespeople, customers and equipment to all locations around the world on schedules independent of the airlines. Far from being "toys" or "playthings", they are tools of commerce, maximizing business opportunities and enabling companies to travel to places at times otherwise impossible using commercial transportation. Imposition of a "luxury" tax on what has become a necessary capital investment for many businesses would be total repudiation of the uses to which these aircraft are put.

General aviation aircraft are also used for purposes other than business transportation. Examples include use as air ambulances, in energy exploration, agricultural application, aerial surveillance and search and rescue. The productive uses of general aviation aircraft, aside from their use in the transportation of persons or cargo for hire, strongly argues against their being considered "luxuries."

The Options also fail to recognize the contribution made to the nation's balance of trade and productivity through the use of general aviation aircraft. Only by maximizing the ability of American business to compete, both at home and abroad, will substantial progress be made in resolving the twin dilemmas of our national trade imbalance and budget deficit. Enactment of a "luxury" tax on general aviation aircraft, with concomitant impact on the flexibility and ability of American business to compete, would be detrimental to resolving the very problem from which it stems, namely the need to reduce the budget deficit.

Finally, a "luxury" tax on general aviation aircraft is ill-advised because of the damage which would be done to what remains of a once-vibrant manufacturing industry and its possibilities for the future. Once the world leader, the domestic general aviation manufacturing industry has fallen on hard times, with only 1495 new aircraft delivered in 1986, the fewest since World War II. In 1984, Cessna Aircraft, by all measures then the world leader, closed its piston-powered aircraft manufacturing facilities. Piper Aircraft now only makes one model continually, with others being made on an "as-needed" basis. Beechcraft, also a major manufacturer, makes only two piston-powered models. By contrast, various foreign manufacturers, including those from Canada, Brazil, France, Great Britain and Italy collectively threaten the long-standing preeminence of American companies in this field.

In light of the substantial and certain long-term damage which would be done to the industry and the simple fact that these aircraft are not "luxuries," we urge this Committee to remove from consideration any proposals to levy a "luxury" tax on general aviation aircraft.

INCREASING AVIATION FUEL TAXES BY FIVE OR TEN CENTS

As noted above, the Options include a proposal to increase the existing aviation fuel taxes by five or ten cents per gallon. Currently, aviation fuels used for non-commercial purposes are taxed at twelve cents per gallon of aviation gasoline and fourteen cents per gallon of turbine (jet) fuel. The revenues from these taxes are deposited into the Airport and Airway Trust Fund. An additional tax of one-tenth of cent per gallon is imposed for deposit into the LUST Fund. When coupled with the various state and local excise and sales taxes imposed, a significant portion of the cost of a gallon of aviation fuel, which averaged $1.86 for 100LL (100 octane Low-Lead) gasoline and $1.70 for turbine fuel in 1986, is comprised of tax. The proposal before you would increase the Federal tax burden on non-commercial general aviation operators to a maximum of 22.1 and 24.1 cents, a jump of 83% and 71%, respectively, at the Federal level alone. As some states have recently increased their taxes on aviation fuel, operators could well be facing average prices in excess of $2.00 a gallon for aviation gasoline and $1.85 for jet fuel if these proposals are adopted.

In order to adequately explain the inequity of imposing increased fuel taxes on general and business aviation, we must first present some background on the current taxes and the Airport and Airway Trust Fund. As the Committee is aware, the revenues from these taxes are deposited into the Airport and Airway Trust Fund, a funding mechanism dedicated to airport and airway system development. Since the Trust Fund's inception in 1971, it has never been at a deficit. In fact, in most years it has maintained a surplus.

Currently, the unobligated surplus reposing in the Fund amounts to approximately $5 billion. These unobligated funds are providing aviation users, and consequently the economy, absolutely no benefits. In fact, the only purpose served by these unobligated funds is to make the overall budget situation appear, on paper, to be slightly better. Ironically, the instant proposals stem from the same desire; to make the overall budget situation appear slightly better. Thus, another argument against these tax increases is the fact that aviation system users are already contributing to a reduction of the budget deficit through Congress' withholding of these funds from their intended purpose.

Since well before enactment of aviation system improvement legislation in 1982, which increased these taxes to their current rate, aviation users have rightly complained these funds are not being spent for the purposes intended. That they are needed for airport and airway system development certainly comes as no surprise to anyone who has paid attention to the public debate on the adequacy of this nation's air transportation system in recent months. To those who use the system on a daily basis its needs are a painful, often time-consuming, reality. Certainly, frequent flyers such as yourselves need no demonstration that we need to move ahead with the process of modernizing and improving air transportation in this country.

Realizing this, and in attempting to build-in incentives for these much-needed funds to be spent, the Committee on Public Works and Transportation on June 12 recommended that this Committee reauthorize these taxes at their current levels. The Public Works Committee recommended that reauthorizing legislation include a tax reduction "trigger" mechanism, as is found in H.R. 8, to provide automatic reductions in these and other taxes if funding for aviation programs falls below authorized levels. The Public Works Committee continued:

> We believe that a tax trigger would help avoid a repetition of the experience of the past five years in which the revenues contributed by users to the Trust Fund were not fully spent but were used, in effect, to reduce the deficit in the general budget.

Clearly, aviation users such as we represent cannot support and must oppose any proposal which would increase these taxes. This is especially true when the instant proposal calls for these revenues to be allocated to general revenue, not to the already-bloated Airport and Airway Trust Fund. If these taxes are increased further, thereby increasing operating costs, another major disincentive will have been created for those who would seek to use general aviation aircraft for business reasons.

When considering the need to reauthorize aviation fuels taxes, we strongly urge this Committee to discard any notion of increases for the purpose of balancing the budget. Indeed, taxes already levied on aviation users are contributing to the budget-balancing effort to the tune of $5 billion. Instead, we urge retention of the present rates, with the revenues derived from them to be wholly deposited into the Airport and Airway Trust Fund, and inclusion of the tax reduction "trigger" mechanism as recommended by the Committee on Public Works and Transportation. To increase these taxes would be to totally ignore the contributions to the economy made through the use of these aircraft, adversely affect general and business aviation users and have additional drastic affects on an already-moribund manufacturing industry.

INCREASING THE TAX ON TRANSPORTATION OF PERSONS BY AIR

The Options contain a proposal to increase the existing tax on transportation of persons by air from the current rate of eight percent of its cost to ten percent. Commonly known as the "airline ticket tax", this tax is also paid by air taxi customers, charter groups and, sometimes, on amounts "charged-back" between related companies for the use of their aircraft, in addition to airline passengers.

Given that the revenues generated by this tax are also deposited into the Airport and Airway Trust Fund, our reasons for opposing this proposal are the same as for opposing increases in aviation fuel taxes. This tax should simply be reauthorized at its current level and made subject to the tax reduction "trigger" mechanism as is recommended by the Public Works Committee.

INCREASING TAXES FOR TRUST OR SPECIAL FUNDS

Another proposal found in the Options would increase Federal excise taxes deposited into trust or special funds such as the Airport and Airway Trust Fund by 33 percent to offset "implicit contributions" from general revenue to those funds. An additional option includes another increase equivalent to the supposed loss to the Treasury from tax-exempt revenue bonds used to finance related activities. These proposals, if applied to the Airport and Airway Trust Fund, fail in their consideration of the realities of the taxes imposed on aviation system users, how these revenues are used and the long-standing public policy behind them.

The proposal to address so-called "implicit contributions" assumes those paying this tax have the option of whether to purchase air transportation or aviation fuel, in the same manner as one who might purchase tobacco products or alcoholic beverages. That is simply not the case. More than 90% of all inter-city travel in the United States is by air. In addition, when considering the decline of rail transportation in all but the Northeast Corridor, the failing inter-city bus industry and the impracticality of travelling by automobile, even the discretionary traveller has no choice but to fly. Additionally, alternate modes are not even viable if the traveller is interested in the fastest means, as business travellers often are. Thus, even if not regressive in the conventional sense, an increase in these taxes for the reasons espoused in the Options is regressive in fact. As these taxes are not generally deductible to an individual, and would not be levied except for the purpose of aviation system development, the concept of "implicit contributions" should not be applied.

The proposal to increase these taxes by an additional amount to offset the supposed revenue loss to the Treasury from tax-exempt bonds also fails to consider the reality of aviation system funding. Even if all funds allocated to the Airport and Airway Trust Fund were immediately spent to improve the system, many billions of dollars in unmet needs would exist. To make up for this shortfall, many airport sponsors and municipalities have had to resort to tax-exempt revenue bonds to finance these much-needed improvements. As Congress has repeatedly approved their use for aviation system development projects and woefully underfunded the Federal improvement programs, it has set forth a policy that they be used in this fashion. Now, the Options would abrogate this policy and penalize aviation system users for a drain on the Treasury brought about by Congress' failure to provide a program of adequate size and scope in conjunction with its long-standing policy that these bonds be used in this fashion. Few actions would undermine the user fee concept, and the faith users have placed in this system for funding aviation improvements, than would adoption of this proposal.

We urge this Committee to abandon such proposals. The "macro-economic mumbo-jumbo" from which they stem fails utterly to consider long-standing Congressional policy in this area as well as the regressive nature such increases would have.

CONCLUSION

This Committee is faced with a most difficult and, clearly, unpopular task. Your task is no doubt made more difficult by the Joint Committee's inclusion of detrimental and counterproductive proposals such as those we have outlined today. Accordingly, we strongly urge you to discard these proposals for additional taxes on aviation. The revenues involved are insignificant in comparison with the totals required, the economic harm which would be wrought through their enactment would in fact damage the overall deficit reduction effort from which they stem and for which aviation users are already paying, dearly, for very little in benefit.

The overwhelming need to expand and improve airports and modernize the 1950s-era air traffic control system equipment also has implications for the economy and for the budget deficit. As inefficiency becomes the norm and delays and circuitous routings take their toll on productivity and competition, the needs will become even more acute. Even so, the very real requirements for increased productivity and competition in relation to foreign-based industry simply will not be met if general and business aviation are subjected to stifling tax levels such as have been proposed. Instead the result will be the inability of the nation's air transportation system to support the economy's demand for air travel.

Thank you for allowing us to submit this statement. We stand ready to provide this Committee any additional information it may require.

SURGEONS INCORPORATED
OF ZANESVILLE
STERLING W. OBENOUR, M. D.
1036 MAPLE AVENUE
ZANESVILLE, OHIO 43701

July 16, 1987

The Honorable Dan Rostenkowski
House Committee on Ways and Means
1102 Longworth House Office Building
Washington, D. C. 20515

Dear Chairman Rostenkowski,

Regarding a Proposal before The House, Ways and Means Committee to impose a 10% "luxury" tax on general aviation aircraft and fuel:

The imposition of this tax on a small segment of the transportation industy is illogical and inequitable. The tax offers no special services to the air traveler. Further, general aviation air travel is not a luxury, it is an every day part of our transportation system as are buses, automobiles, air liners and trains.

I must protest this punitive tax on a small group of our citizens.

Thank you for your consideration.

Very truly yours,

S. W. Obenour, M. D.

SWO:bg

PUBLIC
SERVICE
INDIANA

W. E. George
Senior Vice President -
Power

July 23, 1987

The Honorable Dan Rostenkowski, Chairman
Committee on Ways and Means
1102 LHOB
Washington, D.C. 20515-6348

Dear Mr. Rostenkowski:

This letter is in regard to the proposal for a 10% luxury tax on general aviation aircraft and an additional 10¢ fuel tax on aviation gasoline which has been presented to the House Ways and Means Committee.

I urge you to use your influence to prevent this proposal from being adopted by the Ways and Means Committee for the following reasons:

- General aviation aircraft are not luxury items. They are a valuable and necessary business tool for personnel and equipment transportation.
- General aviation aircraft give professional, medical and service personnel access to hundreds of communities not served by commercial airlines.
- Emergency and life savings units use "general aviation" equipment and in no way is this use a "luxury".
- Aviation fuel already has a 12 to 14 cents per gallon tax which seems to be more than general aviation's share of providing for airport improvement and other funds.

We who fly for business and personal reasons do not understand the conception that general aviation aircraft are "play things". These aircraft are vital to community services and business needs.

Sincerely,

SW

1000 East Main Street, Plainfield, Indiana 46168 317 .. 838 . 1401 from the desk of...

JAKE RANKIN

7-17-87

HON DAN ROSTENKOWSKI
HOUSE WAYS & MEANS COM
WASH DC

DEAR SIR:

I AM WRITING TO URGE YOU TO OPPOSE NEW TAXES ON GENERAL AVIATION AIRCRAFT AND AVIATION FUEL. A HEALTHY AVIATION INDUSTRY IS ESSENTIAL FOR OUR COUNTRY BUT IT IS SLOWLY BEING STRANGLED TO DEATH BY HIGH TAXATION AND TORT LAWS WHICH PUSH INSURANCE PREMIUMS OUT OF SIGHT.

IF YOU NEED NEW MONEY I SUGGEST YOU RAISE IT BY CUTTING SPENDING LEVELS. FOR INSTANCE, THE FARM PROGRAM. FARMERS ARE PUTTING CROPLAND INTO GRASS AND COLLECTING FEDERAL MONEY FOR THESE SET-ASIDES. THEN THEY TURN AROUND AND RENT OTHER LAND TO GROW CROPS THAT QUALIFY FOR FEDERAL SUBSIDIES AND LOANS. WE STILL HAVE OVERPRODUCTION. IT IS CRAZY! US AVIATORS OUGHTEN TO HAVE TO PAY FOR IT!!

SINCERELY

3623 72ND PLACE S.E.
MERCER ISLAND WA 98040

720 Sundown Court
Las Cruces, NM 88001
17 July 1987

The Honorable Dan Rostenkowski
Chair, Ways and Means Committee
U.S. House of Representatives
Washington, DC 20325

Dear Congressman Rostenkowski:

I express my opposition to the proposed 10 percent luxury tax on general aviation aircraft and then additional 10 cents per gallon aviation fuel tax.

First of all, I perceive aircraft ownership as an already expensive necessity. Aviation is not my primary occupation, but I do use my aircraft in business related travel and, with many miles between destinations in the southwestern United States, it saves many non-productive hours on the road between stops. There are others, who do not fly, whose livelihoods depend upon aviation. Consider the farmer's dependence upon the crop duster: Any tax on the crop duster is passed along to the farmer as a hidden cost and neither of them eats any better.

Second, our already imposed taxes of 12 and 14 cents per gallon do not bear the fruit intended. The FAA still continues to thwart the primary intent of the General Aviation Trust Fund which is basically to improve the facilities and services to General Aviation but which the FAA persistently continues to use to improve the services and facilities available to commercial aviation and to meet FAA administrative expenses. General Aviation has been the sacrificial lamb in the on-going consolidation of Flight Service Stations into regional offices for which one must wait too long to obtain essential information (and I live in a low density area). So make the FAA administer the General Aviation Trust Fund correctly!

Third, because of the long term rising costs of production and development, most general aviation aircraft are no longer being produced. I consider "general aviation" to be synonymous with "personal aviation" as opposed to "corporate aviation." Because I own a 4-seat Cessna 182 RG (retractable gear) as a personal aircraft, I am reasonably aware that Cessna has ceased production of very nearly all of its line except those that might be considered corporate aircraft (jet and prop-jet). I am also aware that there are simply no general aviation trainer aircraft being produced (specifically the ubiquitous Cessna 150) and I believe that Piper has ceased much of its production of 2 and 4-seat aircraft. What they are producing cost more than $1,000,000 to purchase (obviously not for the average personal aircraft owner--my yearly salary is only $38,000). Other than Cessna and Piper, I am aware of no other general aviation aircraft manufactures producing general/personal aircraft trainers. Any aircraft in production today are much too sophisticated and expensive to be used as trainers; further taxation serves to legislate general aviation out of existence.

Fourth, to what purpose is all of this "luxury tax" intended? If it doesn't help the payer then why tax him? Why not put a luxury tax on 4 and 6 place boats that people use for none other than water skiing and other recreation? I was a boat owner for 10 years and I never used the boat for business purposes; alternatively, I use my personal aircraft 50-50 for business and recreational purposes! Part of my "business use" of my aircraft is commuting to drills as an Army Reservist for which I am not fully reimbursed and which is not fully compensated by income tax deductions and exclusions (it comes out of my "patriotism"); in Las Cruces I live 250 miles from my primary (Albuquerque) and alternate (Roswell) drill locations of my unit and I don't care how you compute travel costs and time I still come up short (cash, endurance and sense of humor). Have you ever tried a Friday after work 5-hour drive to a weekend activity that begins at 8AM Saturday and ends at 5PM on Sunday followed by a 5-hour drive back home to make work at 8AM Monday?. Believe me, airplanes ain't no luxury!!!

Fifth, I am a member of the Civil Air Patrol which performs other services than searching for downed aircraft. Many of the CAP members own aircraft and contribute much out of their pockets to the safety and rescue of others that goes well beyond the mere search and rescue of downed aircrews for which the CAP is most associated. General aviation (the CAP) even sank a German U-Boat in World War II! The bombs might have been provided by the Government, but the aircraft was personally owned and risked for defense.

Sixth, if the Tax Reform Act of 1986 increased my taxes (and it did) and reduced and eliminated so many "loopholes" (most of mine), then why, why do you (the Government) need more money? For what purpose is all of this financial gain to be used?

Sincerely,

Charles D. Revie
LTC, US Army Reserve
FAA Commercial Pilot #260627117
AOPA #626871
Beleaguered Tax Payer

July 17, 1987
2009 Mayfair Drive
Kokomo, In 46902

Hon. Dan Rostenkowski, M. C.
Congress of the United States
Chairman, Ways and Means Committee
House Office Building
Washington, D. C. 20215

Dear Chairman Rostenkowski:

Please block the proposal which imposes a 10 percent luxury tax on General Aviation aircraft and which would establish an additional 10 cents per gallon Aviation Fuel Tax on top of the 12 and 14 cents per gallon tax now in existence.

The House Ways and Means Committee will act on these proposed tax increases on July 20, as you are aware.

Congressman, General Aviation is not a luxury, but is a fundamental transportation mode. I am a pilot and an aircraft owner, and I cannot pay additional taxes. The Aviation Trust Fund is being held in some sort of escrow, and the Administration will not allow its use.

Please vote against these crippling proposals. Contrary to Ann Landers, most General Aviation aircraft owners are not "fat cats", but people of only average means, usually partnership owners with several other persons (my own case).

Thank you for your assistance.

Sincerely,
Robert J. Ropes
Robert J. Ropes

16 July 87

House Ways & Means Comm.
House of Representatives
Washington D.C. 20515

Gentlemen:

PLEASE PLEASE block the Luxury Tax on general aviation aircraft and 10 cents added on the aviation fuel tax.

I am a pilot just barely able to fly now and again and this extra cost will just about put me out of flying after 43 years. (I was a pilot in World War II)

We have BILLIONS in the Aviation Trust Fund which should be spent to improve Airports and safety. When will this be done?????

Thank you for your consideration of the above, as general aviation is just about on its last legs now. Don't push it down further.

Sidney F. Shapiro
180 Grove Park Rd. S.
Memphis Tn. 38117

July 17, 1987

Mr. Dan Rostenkowski,
Chairman Ways and Means Committee.

Sir:

RIDICULOUS: Webster defines ridiculous as "Deserving or causing ridicule or derision; absurd, preposterous, or laughable."

Mr. Rostenkowski: In speaking for myself I believe I voice the opinion of most every airplane owner and those who use airplanes in whatever manner who has to contemplate the imposition of two more burdensome taxes, a luxury tax and an added fuel tax. The "laughable" part of Webster's definition of ridiculous definitely does not apply to the thought of two more burdens to an already overtaxed and over regulated section of society.

Furthermore, there are thousands of people who have devoted their lives to an aviation industry which has effectively been put out of business because of absurd liability suits, taxes, and inhibitive regulations. I am most sure that almost all these people will not believe that these new tax burdens will improve their chances of ever going back in to aviation related industries.

LUXURY: Webster defines luxury as any "nonessential, usually costly or scarce, which is personally gratifying: free or constant indulgence in such nonessentials."

I wonder, does your average businessman regard his airplane [illegible]? Or does he regard it as a useful tool which he uses to expedite his business?

HOBBY: Webster again. "An activity carried on outside of a major occupation for mere pleasure, relaxation, an avocation."

One might classify Burt Rutan as a hobbyist. He was, and I suppose still is, a member of the Experimental Aircraft Association. Burt designed and helped build the Voyager which flew around the world non-stop. Was that airplane a luxury, a hobby, or was it a business tool which advanced the state of aviation art into new dimensions.?

Mr. Rostenkowski, there are only 200,000 airplanes in the U.S. give or take a few. Are commercial airliners a luxury to their owners? Are you going to call a businessman's working airplane a luxury? Are you going to call a training plane a luxury when young people training in them are doing so because they envision making the airplane useful in their careers?

Mr. Rostenkowski, I strongly suggest that your committee does its home work on the consequences of more taxation being added to an already overloaded group of people. Scratching through general aviation for a comparatively few dollars is "Make do" work. Why not do something constructive like figuring out how to keep the trillion dollar deficit from getting any larger?

Sincerely.

FLYING TIGER LINE, Retired.
Box 3119,
Shell Beach CA.
93449

TROYER BROTHERS, INC.

Growers & Shippers

R.D. # 4
Union City, PA 16438
Phone 814/438-3110

P.O. Box 599
Immokalee, FL 33934
Phone 813/657-4635

July 17, 1987

The Honorable Dan Rostenkowski
United States Congressman
Chairman, House Ways and Means Committee
Washington, DC 20515

Dear Congressman Rostenkowski:

I wish to protest the federal tax proposal to impose a 10 per cent luxury tax on general aviation aircraft and an additional 10 cent per gallon aviation fuel tax.

The exhorbitant increase in purchasing and operational cost of private aircraft that would be created by these proposals would subsequently deny the freedom of ownership to many, therefore making it an infringement of individual rights. Furthermore, I consider it unfair to attach a luxury tax to one area of "luxury". After all, who or what is to determine what is or is not a luxury? General aviation, in my estimation, is not a luxury but a fundamental tool.

Please vote against these proposals.

Respectfully,

Donald Troyer
President

DT/jb

W&P Nautical, Inc.
222 SEVERN AVENUE, ANNAPOLIS, MARYLAND 21403 TELEPHONE (301) 268-7700

July 16, 1987

The Honorable Dan Rostenkowski
Chairman, Committee on Ways and Means
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

I am a "general aviation" pilot and do a major amount of my flying for business.

I find it appalling that the House is considering singling out this area for a luxury tax and an additional tax on fuel (which is already 60-80% more expensive than car or boat fuel).

Stop fooling around -- raise taxes generally, if you must, but stop picking on "easy ways" out. How about taxing boats and cars similarly -- too touchy you say . . .

Please vote against this initiative.

Sincerely,

James E. Templeton

James E. Templeton
President

JET:dn

3013 Caves Road
Owings Mills, MD 21117
Congressional District 3
AOPA Member #908764
July 16, 1987

Honorable Dan Rostenkowski
Chairman
House Ways and Means Committee
House Office Building
Washington, D.C. 20515

Dear Honorable Rostenkowski:

I am writing this letter to STRONGLY OPPOSE the federal tax proposals which would impose a 10 percent luxury tax on general aviation and dictate an additional 10 cent per gallon aviation fuel tax on top of the existing 12 and 14 cents per gallon respectively on avgas and jetfuel.

General aviation is a mainstay of our transportation system supplementing transportation between commercial hubs and providing the sole efficient transportation to many outlying areas not served by the commercial carriers. The general aviation industry has recently suffered with the elimination of the 10 percent tax credit and from increased insurance cost caused by overzealous lawyers and our over generous juries.

The proposed 10 percent luxury tax would only serve to further damage the general aviation industry and its installed base by negatively impacting product demand and thereby preventing a broader tax revenue base at both the manufacturer and maintenance levels. I would also add that general aviation is a basic utility and no more of a luxury than automobiles or trucks and as such should not be singled out for a luxury tax. As for the fuel tax, general aviation already has the highest category fuel tax which serves to fund the Aviation Trust Fund now approaching a significant surplus. This additional tax would only serve to further more critically burden a very useful industry. These two actions if passed would be similar to poisoning the goose that laid the golden egg.

I hope that you will seriously consider the negative impact of these proposal that would overly burden the general aviation industry and OPPOSE their pursuit.

Sincerely,

Peter S. Welles

L.B. WILLETT Ph.D.
Educational Services
Animal Sciences

Telephone: (216) 264-9859

3762 Messner Road East
Wooster, Ohio 44691
U.S.A.

July 15.1987

Congressman Dan Rostenkowski
Chairman, Ways & Means Committee
U. S. House of Representatives
House Office Building
Washington DC 20515

Dear Congressman:

I strongly oppose the proposed **luxury tax** on **general aviation aircraft** and the **10 cent per gallon aviation fuel tax.** These proposed taxes are extremely unfair to those of us who depend on our general aviation aircraft for business.

I operate a small consulting business to help regulatory agencies and livestock producers that are affected by toxic chemicals. My single engine aircraft is critical to this business venture with 92 to 98 percent business use annually. **My aircraft is a business tool and not a luxury.** Since my small business generates less than $30,000 annually, any additional taxes would be extremely difficult to absorb considering the already high costs associated with aviation.

I urge you to block these proposals which are unfair and based on the false notion that small aircraft are toys for the very rich.

Sincerely,

L.B. Willett

L. B. Willett Ph.D.

LUXURY EXCISE TAXES - JEWELRY

COMMENTS OF THE
AMERICAN WATCH ASSOCIATION
BEFORE THE HOUSE
COMMITTEE ON WAYS AND MEANS
WITH RESPECT TO JEWELRY EXCISE TAXES

The American Watch Association (AWA) is a trade association of approximately 40 United States companies engaged in the importation, assembly and manufacture of watches and watch movements for sale in the United States and world markets. AWA members include most major companies in the U.S. watch industry, including the firms that market such well-known brands as Armitron, Baume & Mercier, Belair, Bulova, Cartier, Casio, Citizen, Concord, Corum, Ebel, Hamilton, Helbros, Innovative Time, Jaz, Jules Jurgensen, Lasalle, Longines, Lorus, Lucien Piccard, Marcel, Movado, Omega, Piaget, Pulsar, Rado, Raymond Weil, Rolex, Ronda, Seiko, Swatch, Tissot, Wittnauer and many others.

In this statement, the American Watch Association expresses its strong opposition to possible options to increase Federal revenues by means of an excise tax on watches and jewelry articles. See Description of Possible Options to Increase Revenues, the hearing pamphlet prepared by the Committee staff and the staff of the Joint Committee on Taxation, Jacket No. 74-267, at 45-6.

The last such selective excise tax on jewelry articles, including watches, was imposed during World War II. The tax was a failure and was repealed by the Excise Tax Reduction Act of 1965. Among the chief reasons for its repeal were the discriminatory nature, burden and inefficiency of the tax. See H.R. Rep. No. 433, 89th Cong., 1st Sess. 9, 16 (1965). While the wartime emergency surrounding the enactment of such a tax no longer exists today, the inherent reasons for the tax's ineffectiveness remain. Simply stated, a jewelry excise tax was bad tax policy when it was repealed more than 20 years ago -- Congress should not turn back the clock and repeat a serious mistake.

1. A Selective Excise Tax On Watches And Jewelry Would Be Unfair And Discriminatory.

An excise tax that is imposed on watches and jewelry, and not on all consumer products, would be unfair and discriminatory, causing diversion of watch and jewelry sales to other competing, untaxed products, such as cameras and clothes. Indeed, the possible proposals for excise taxes under consideration by the Committee include watches and jewelry as so-called "luxury" items but do not touch personal computers, golf clubs, cameras, clothing and other products that compete directly with watches for the consumer's discretionary dollar.

Such resulting market distortion was a major reason for the excise tax repeal in 1965. The Committee emphasized this fact in its report accompanying the Excise Tax Reduction Act of 1965:

> "These selective excise taxes tend to reduce sales and therefore reduce incomes and jobs in the industries which produce the taxed goods. In these ways, selective excise taxation

> results in arbitrary and undesirable distortions in the allocation of resources and in this manner interferes with the free play of our competitive market." H.R. Rep. No. 89-433 at 9.

The fundamentals of the marketplace have not changed so significantly since that time that the discriminatory and distortive nature of such an excise tax is any less severe than it was 20 years ago when it was repealed.

Moreover, as long as an excise tax were selective rather than universal, it would not reduce consumer spending nor encourage savings. In the watch and jewelry industry, for example, industry sources estimate that 65 percent of all sales are made to consumers for gift-giving and special occasions such as anniversaries and graduations. Consumers requiring a gift for such occasions and finding highly-taxed watches and jewelry to be too expensive will not save their money -- they will spend it on a competing industry's untaxed product, in order to give a gift within their price range.

2. It Is Impossible To Define The Threshold Between Watches As Necessity And As Luxury

The proposed excise tax would be targeted at so-called "luxury" goods. However, as the Committee staff correctly states in its hearing pamphlet, "(t)here are few objective standards available to use in deciding which articles are luxury goods." This also was recognized when the tax was repealed in 1965. For example, the Ways and Means Committee Chairman Wilbur Mills, in the floor debate on the Excise Tax Reduction Act (Congressional Record of June 2, 1965, at 11872), refuted the justification of excise tax advocates that they are imposed on the sale of luxuries as contrasted to necessities: "But in our society today it has become almost impossible to distinguish between luxuries and necessities."

A watch, as a timepiece, is a functional article and may be viewed as more of a necessity than a luxury, whatever its price. A $150 watch is not a luxury item; nonetheless, the selective excise tax options contemplated by the Committee staff would tax a $101 watch but exclude imported caviar, silk scarves, English shoes, designer dresses, Persian carpets and antiques that cost much more than most watches and jewelry products.

Furthermore, price alone does not distinguish necessities from luxuries. A $75 watch with a plastic or textile band is less expensive than a $250 watch with a stainless steel bracelet; however, it may be more functional for the low- or middle-income consumer, depending on the use to which it will be put.

3. An Excise Tax On Watches Would Discriminate Regressively Against Lower And Middle Income Consumers, Not The Rich.

Excise taxes are generally considered to be regressive. This is particularly so with respect to watches because whether or not one labels watches as "luxuries," the fact is that for most Americans a quality watch is as important as clothing and shoes. Americans from all walks of life (not just the rich) have traditionally wanted to invest in timepieces as soon as they could afford to do so. Moreover, the retirement gold watch has come to be a traditional reward for a job well done.

An excise tax on the retail price of a watch may well make it that much more difficult for a low- or middle-income consumer to afford the watch. The actual effect of such an excise tax would be a highly regressive one affecting the low- or middle-income consumer a great deal more than the upper-income consumer. Not only would moderately priced watches be pushed out of the reach of some people, but more expensive watches given to commemorate such occasions as graduation, engagements and marriages, promotions and retirements could become prohibitively expensive.

Most economic distortions generate perverse reactions in the free market. In the watch market, that reaction is likely to be an acceleration in sales of counterfeit watches for people who no longer hope to purchase the real thing. As that happens, the losers will include upper-end watch producers where brands are counterfeited, lower-end producers forced to compete with counterfeiters and the Federal government, which will lose revenue from legitimate production.

4. A Luxury Tax Would Be Difficult To Administer And Would Place A Costly Burden On Watch And Jewelry Retailers.

It bears emphasis that an excise tax on watches and jewelry would need to be collected at the retail level on literally millions of transactions. The Committee, in repealing the watch excise tax in 1965, observed that "the compliance burden imposed by the tax is often a severe one in an industry which contains a large number of small, one-family concerns. Moreover, there are difficult problems in determining the actual sales price in the auditing of these returns." H.R. Rep. No. 89-433 at 16.

The administrative burden on the watch and jewelry industry, comprising 100,000 to 200,000 retail outlets, often mom-and-pop enterprises, would be both costly and largely unmanageable. If the pre-1965 experience with luxury excise taxes is an accurate guide, the U.S. Treasury will be saddled with a regulatory nightmare in which the revenues may barely outweigh the administrative costs of enforcement.

Moreover, the tax can be expected to breed a variety of legal evasions. Watch bracelets might legally be sold separately from watch heads and attached after the sales. Pearl necklaces could be sold piece by piece, as could silverware, china, crystalware and so forth.

5. An Excise Tax On Jewelry Would Raise Very Little Revenue.

Disregarding the administrative costs, an excise tax on watches and jewelry is projected to raise a relatively small amount of revenue. The Committee staff hearing pamphlet at 47 estimates that a 10 percent excise tax on the value of jewelry and precious gemstone over $100 would generate only $200 million in revenue in 1988. Coupled with the loss of revenue from the jewelry industry as consumers switch to other products, the unfair burden on small business enterprises, the threat of aggravating the volume of imported counterfeit watches and the perverse impact on lower income taxpayers, an excise tax on watches and jewelry can be expected to do much more harm than good.

* * *

In short, the proposed excise tax on watches is simply a bad idea. It is bad because it hurts industry and decreases employment; it is bad because it unfairly discriminates against certain industries; it is bad because it hits hardest low- and middle-income consumers; and it is bad because it is one of the most inefficient forms of taxation. In our judgment, our country would be much better served, if it must raise revenue, to do so fairly and efficiently -- not through selective excise taxation.

Emilio G. Collado III
Executive Director
American Watch Association
1201 Pennsylvania Ave., NW
Washington, D.C. 20044
703/759-3377

July 15, 1987

PAGR
ANDREW GATES' PRECIOUS JEWELS, INC.
DESIGNERS AND MANUFACTURERS

July 28, 1987

Robert J. Leonard
Chief Tax Counsel
Committee on Ways & Means
U.S. House of Representatives
1102 Longworth House Office Bldg.
Washington, D.C. 20515

Dear Mr. Leonard:

Since I was unable to attend the hearings for the proposed luxury tax, I would like to take this opportunity to state my opposition to it.

The intention of this tax is to impose a luxury tax on wealthy individuals. I do agree that jewelry is a luxury item. However, a wealthy individual, if he wishes to purchase jewelry items, can find a way to do it without paying the luxury excise tax by simply travelling overseas and spending our dollar outside the United States, further deteriorating our trade balance.

In view of the present business conditions in the jewelry industry, it would be most unwise of you to place more of a burden on the American public, jewelry manufacturers and retailers. If the luxury excise tax were to be imposed, the tax would most affect the low to middle income people who purchase jewelry for special occasions - birthdays, anniversaries, graduations, etc.

Why don't you propose a luxury tax on larger, more costly jewelry items ($5000.00 and up) which would attract only the higher income people?

Yours truly,

Andrew Gates

TWENTY WEST FORTY-SEVENTH STREET• NEW YORK, NEW YORK 10036
PHONE 212-719-2170-71

AJA
ARIZONA
JEWELERS
ASSOCIATION

P.O. BOX 17135, SUITE 514 • PHOENIX, ARIZONA 85011 • (602) 957-8539

July 17, 1987

The Honorable Dan Rostenkowski
Chairman
House Committee on Ways and Means
U.S. House of Representatives
Washington, D.C. 20515

RE: RETAIL EXCISE (Luxury) TAX

Dear Congressman Rostenkowski:

The Arizona Jewelers Association representing over 175 retail jewelers throughout Arizona request your support to not allow a retail excise tax on jewelry to be enacted.

Reasons include: a luxury tax would:

1. Distort puchase decisions.
2. Be burdensomefor small business (this involves most of our members).
3. Be costly to administer.
4. Be unfair and inequitable to consumers
5. Not raise significant revenues.
6. Lend itself to enforcement and collection problems.
7. Possibly encourage tax avoidance.

Note: At the time Congress last repealed the selective excise tax on jewelry in 1965, the Ways and Means Committee noted that such taxes were a source of undesirable discrimination.

You are urged to defeat this measure.

Sincerely,

Patricia Berning
President

AFFILIATED WITH THE JEWELERS OF AMERICA INC.

Ashcroft + Co.
Fine Gems and Jewelry
29 East Madison
Suite 208
Chicago, IL 60602
312-641-6540

Ashcroft+Co.

7/28/87

Dear Mr. Robert J. Leonard,

Instead of having my secretary typing a note to you, I fell compelled to share a few thoughts and personally take the time to write it myself.

I'm concerned that the House ways and Means Committee is considering a luxury tax on Gemstones, jewelry and watches. I'd like to share to examples of this type of tax. One is Canada the other austria. Austria is probably the leading country where tax evasion is concerned. In these countries the jewelry industry has suffered greatly so in effect the government has lost revenue! This taxation has encouraged, black market activities as well as other forms of tax evasion. This tax punishes the wealthy and makes it difficult for the small businessman to compete with the chain and discount type of businesses. In a day of high cost of living don't add pressure to an industry which relies on "good times" for sales. I don't feel theres a place for this Socialistic attitude in america. Thank-you for your time.

Dan Sarros
Director of Operations

b david

B. DAVID COMPANY

**JEWELRY DESIGNERS
AND MANUFACTURERS**

PHONE 513/541-1888
1624 KNOWLTON STREET
CINCINNATI, OHIO 45223

July 27, 1987

House Committee On Ways And Means
U.S. House of Representatives
1102 Longworth Office Building
Washington, D.C. 20515

Dear Sir:
Please oppose the proposed 10% excise tax on jewelry.

1. Jewelry (including watches, wedding rings etc.) is no more of a luxury than expensive clothing, expensive cars, boats, travel and more.

   With an excise tax on jewelry, you discriminate against one segment of the economy.

2. Of the 40,000 jewelry stores in this country, most are small, family-run businesses, working hard to pay their bills.

   A jewelry tax would decrease their sales and increase their overhead.

3. Jewelry manufacturing is a highly competitive industry, made up of thousands of small manufacturers. Of all industries, it is the wrong one to hit with an excise tax.

   Congress must find an effective and equitable method for closing the federal deficit. Why don't you start with legislation prohibiting boondoggling--or giving the president a line item veto.

Sincerely,

Mickie Winkler

Mickie Winkler
Director Sales & Marketing

kp

EUROPEAN OFFICES • ANTWERP, 90 RUE DU PELICAN • AMSTERDAM, 53-55 SARPHATISTRAAT

BAUMAN-MASSA JEWELRY COMPANY

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CARDINAL

915 OLIVE STREET
SYNDICATE TRUST BUILDING,
SUITE 204C
P. O. BOX 668
SAINT LOUIS, MO 63188

July 16, 1987

House Ways and Means Committee
1102 Longworth House Office Building
Washington, D C 20515

Gentlemen:

I am very displeased with proposed option to impose a 10% retail excise tax on jewelry, various precious and semi-precious stones and other items.

As this tax was appealed in 1965 because of the burden, inefficiency and discriminatory nature, I can find no reason for it to be re-instituted.

Many of our customers are mom and pop operations. The tax, collection of tax, and additional paper work would be very burdensome to them. The tax will reduce sales for the mom and pop operations and cause unemployment in the jewelry manufacturing distribution and retail trade.

How does one decide which articles are luxury goods and should be taxed? If all consumer products are not taxed then the excise tax on jewelry would be unfair and discriminatory.

I urge the House Ways and Means Committe not to pass such proposed tax - it would be detrimental to the jewelry industry.

Very truly yours,

Janet Monks

Janet Monks

jm:vb

cc - Congressman Richard A. Gephardt
1432 Longworth House Office Building
Washington, D C 20515

August 19, 1987

Congressman Dan Rostenkowski, Chairman
House Ways & Means Committee
1102 Longworth Bldg.
Washington, D. C. 20515

Dear Congressman Rostenkowski:

As an employee of an exclusive jewelry store in the midwest I feel that a 10% luxury tax will discriminate against the average customer.

These are the people who cannot afford to pay CASH but at the same time desire beautiful jewelry as anyone else who is in a position to pay this extra tax.

Please do all that you can to curtail this additional tax. Not only would the American manufacturing work force suffer, but so would the tens of thousand small jewelry retail stores throughout the country.

Thank you for supporting my request.

Cordially,

Carl R. Brown

C. R. Brown
3988 Covert
Evansville, IN 47715

Identical letters were submitted by the following:

Mr. Tim B. Droste, Evansville, Indiana
D. E. Shanks, Newburgh, Indiana
B. L. Wathen, Evansville, Indiana

Busch
Jewelers

ROCKFORD'S ONLY DIRECT DIAMOND IMPORTER

August21, 1987

Honorable Dan Rostenkowski
Chairman Ways and Means committee
1102 Longworth House Office Bldg.
Washington, D.C. 20515

Dear Sir:

There is currently considerable discussion about imposing a "Luxury" Excise Tax on jewelry. I am a jeweler and am concerned about what its effect would be on the million American people whose livelihood is dependent on the jewelry industry - a great many of whom are of minority heritages.

I recognize the need for additional sources of Federal revenue, but I suggest that imposing a selective sales tax on the jewelry industry might well do more harm than good for the country. It would not only upset employment patterns, but also put the burden on an industry that can ill afford it. We are now competing harder than ever for the discretionary dollar and are being seriously buffeted by all sorts of imported products.

Please make note of my plea about this blatantly discriminatory tax proposal.

Very truly yours,

BUSCH JEWELERS

Donald A Busch

DONALD A. BUSCH, President
DAB/ep

1960 PAWLISCH DRIVE • ROCKFORD, IL 61112 • (815) 332-2332

C. A. JENSEN 709 First Street - Telephone 815/223-0377 - La Salle, Illinois 61301
JEWELERS
ESTABLISHED 1919

August 21, 1987

Dear Sir:

We are writing regarding the proposed 10% LUXURY TAX on JEWELRY.

To impose such a tax on the Jewelry Industry would cause a serious hardship (because of reduced sales) on thousands of people employed in the design, manufacture, wholesale, and retail divisions of the jewelry industry.

There are many items in the jewelry industry that are definitely not luxuries...watches, wedding rings, modest priced diamonds to announce an engagement...while there are many real luxuries on which no tax is suggested...expensive cars, boats, sports equipment, guns, furs, thousand dollar dresses and suits...the list is unending. Why select one industry to be taxed!

We urge you to do all you can to stop any passage of this very discriminatory tax proposal. Thank you.

Yours very truly,

C. A. JENSEN, Jewelers

Robert A. Jensen
President

osf

Chas. S. Rivchun & Sons, Inc.
JEWELERS
850 EUCLID AVENUE · CLEVELAND, OHIO 44114 · 216/781-0999

July 21, 1987

Washington House Ways & Means Committee
1102 Longworth House Office Bldg.
Washington, D.C., 20515

To: Members of the House
Ways & Means Committee

Gentlemen:

It has been called to our attention that a 10% tax (Excise) on jewelry is now being proposed in Congress .

We wish to point out that in our opinion:

(1) The tax will ruin the U.S. central market for diamonds, business will shift to other markets,

(2) The tax will reduce sales and cause unemployment in the jewelry manufacturing, distribution and retail trade.,

(3) The tax will shift demand from local jewelry products and direct consumer expenditures to other products which may well be imports,

(4) The tax would be very difficult to collect, enforce, or administer

(5) The tax is highly discriminatory

(6) The congressmen will lose votes over this issue

It is difficult for us to get this message to the entire congress, however, by addressing this to the entire House Ways & Means Committee, we hope that the proper persons will listen to our comments.

Trusting that you too will come to see our point of view, we are

Yours very truly,

Sanford Rivchun, Pres.
CHAS. S. RIVCHUN & SONS INC.

Frederick L. Rivchun, Vice Pres.
CHAS. S. RIVCHUN & SONS INC.

mwr:l

JMQB

July 16, 1987 COMMITTEE ON

House Committee on Ways & Means
U.S. House of Representatives
1102 Longworth Office Bldg.
Washington, D.C. 20516

Dear Members of the House Committee on Ways and Means,

I am against a 10% tax on jewelry and other items that might be termed by some to be luxurious. This type of tax unfairly burdens one aspect of the retail market and those who are involved in it. It tends to reduce sales and therefore reduce income and jobs in the industries that produce the stated goods. It also tends to penalize creative artists involved in its production and related fields.

Sincerely,
Jerome L. Cox

927 MARSHALL ST. N. E
MPLS., MINN. 55413

DDC

DIAMOND DEALERS CLUB, INC.

580 Fifth Avenue at 47th Street • N.Y., N.Y. 10036 • Tel. (212) 869-9777 • Telex No. 421005

July 8, 1987

JACK SIGMAN
HONORARY PRESIDENT
WILLIAM T. STEINLAUF
HONORARY SECRETARY
ISI RUBIN
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ALBERT J. LUBIN
DIRECTOR EMERITUS
S. HERMAN KLARSFELD
GENERAL COUNSEL
ABE MICHAEL SHAINBERG
EXECUTIVE DIRECTOR

Hon. Robert J. Leonard
Chief Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington D.C. 20515

RE: COMMITTEE HEARING ON PROPOSED EXCISE TAXES

Dear Mr. Leonard:

I am writing on behalf of our membership and industry in opposition to a luxury excise tax on diamonds, gemstones and jewelry items. We are a trade association and exchange comprised of approximately 2,000 members on 47th Street in Manhattan. Additionally, we represent the interests of 15,000 odd diamond manufacturers, importers, dealers, cutters, polishers, cleaners, sawyers and the employees of these individuals.

This New York industry is finally on the rebound from a serious setback in the early 1980's. The U.S.A. through 47th Street is prominently known as the "center" for large goods of high quality. The continuation of this status and niche in the world market depends entirely on U.S. competitiveness in this arena. The imposition of a luxury excise tax would force consumers to travel elsewhere to buy these items and destroy whatever advantage we worked so long for. We would lose this power as a marketplace which would re-awaken other markets; most notably in Switzerland, Antwerp, the Middle East and the Far East.

Additionally, the lower priced lesser quality goods will be greatly affected as wholesalers and consumers would look to the new "centers" for diamonds. Disaster would follow in the form of 30-50% unemployment, company closings and many artisans, workers and businessmen leaving their lifelong chosen line of work.

How many industries can claim a positive trade surplus with Japan? We can. But a luxury excise tax would negatively affect that position as well.

If you would like us to expand on any of our points in person or in writing kindly let us know.

With great respect, I remain,

Sincerely yours,

DIAMOND DEALERS CLUB, INC.

Ralph Bar
President

DONALD HAACK
DIAMONDS

13 July 1987

House Ways and Means Committee
1102 Longworth House Office Building
Washington, DC 20515
Attn: Chairman Rostenkowski

Dear Chairman Rostenkowski,

It has been brought to our attention that on a list of new tax options, a 10% retail excise tax on jewelry and precious metal items has been proposed.

We do not have the complete list of tax options so do not know what other segments of the business sector have been proposed for such a discrimatory tax or what reasoning lies behind this proposition.

Is it because jewelry and precious metal items are a luxury? Then have large cars, expensive carpeting, original paintings, designer dresses, objets d'art, rifles for "collection", stereo and video equipment, yachts and/or sailboats --and a whole host of other items also appeared on the list of excise taxable items?

Has it been considered that some people prefer to invest their available funds in jewelry as a form of "saving" rather than spending it on other possessions which last only a couple of years, not to mention failing to last several lifetimes.

In North Carolina, our customers already pay a 5% sales tax. An added 10% excise tax amounts to 15% added to an already high cost item. Has your committee considered the number of jobs which would be affected adversely by such an enormous discriminatory tax on the jewelry industry?

Surely your committee can come up with revenue producing propositions which would be more equitably distributed over the already heavy-laden body of taxpayers.

Sincerely yours,

Mrs. Donald E. Haack

cc: Members, House Ways and Means Committee

SUITE 2510 · CHARLOTTE PLAZA · CHARLOTTE · NORTH CAROLINA · 28244 · (704) 372-7720
N.C. 1-800-532-6013

FEATURE ENTERPRISES INC.
130 West 46th Street, N.Y., N.Y. 10036 (212) 575-9300

Telex: Int'l 62471

August 24, ~~198~~7

Rep. Dan Rostenkowski, Chairman
Committee on Ways and Means
House of Representatives
1102 Longworth House Office Building
Washington, D. C. 20515

Dear Rep. Rostenkowski:

This letter is being written regarding the proposed "Luxury Tax" on jewelry and watches retailing over $100.00.

We urge you to oppose the implementation of such a tax. It is unfair and discriminatory. The jewelry industry has suffered many bankruptcies in the past few years; hundreds of small retailers have been forced to close down because of the economy. The imposition of such a tax now would bring the curtain down on hundreds of other establishments.

It is hard to conceive of the watch as a luxury item...or the wedding ring. Rather it is a way of life for the majority of the American people. The range of items that ARE luxury items is enormous - imported caviar, silk scarves, English shoes and designer dresses. We cannot understand why the jewelry industry has been chosen to receive the burden of this tax which will be burdensome and costly to administer, both for us and for the government.

This tax was repealed in 1965 and it will not work now either.

We are a manufacturer and employ well over 700 people. It is most important to us to keep the retailers as burden-free as we can, so that they will continue to order from us, and we, in turn, can afford to employ over 700 people. Each cog is a part of a giant circle of humanity and the government must consider the industry or "circle" as a whole.

Please vote "No" on any excise tax measure on jewelry and watches.

We thank you for your consideration.

Very truly yours,

FEATURE ENTERPRISES INC.

Jerome Peterson

Jerome Peterson
President

JP/rh

AGS
REGISTERED JEWELER
CERTIFIED GEMOLOGIST APPRAISER
ACCREDITED GEM LABORATORY

NBS
NATIONAL BRIDAL SERVICE

TELEPHONE
(404) 291-3811

Ford, Gittings & Kane
JEWELERS
312 Broad Street
Rome, Georgia 30161

August 12, 1987

The Honorable Dan Rostenkowski
2111 Rayburn House Office Building
Washington, D. C. 20515-1308

Dear Sir,

The proposed 10% excise tax on the jewelry industry came as a horrible shock to me! I serve as President of the Southeastern Guild of the American Gem Society. During our August meeting the proposed tax was brought to our attention. Everyone present is a respected member of the jewelry industry - most from relatively small independent retail stores. A 10% excise tax on our merchandise would very adversely affect each one of us. It could easily be the difference in a prosperous, economically sound business and a business forced to close. American Gem Society Jewelers are "dedicated to Knowledge, Ethics and Consumer Protection." Following this ideology, our jewelry is priced fairly so as to be equitable to our customers, to pay overhead expenses, and to replenish our inventory. Contrary to what this new law implies - our merchandise is not only luxury for the wealthy. A high percentage of pieces sold are quite necessary - wedding bands recognized by almost every religion as a symbol of commitment, watches and clocks which keep our country "on time" and even Medic Alert jewelry required for the health of many people. To charge 10% tax in addition to each state's sales tax wóuld cause an unthinkable hardship on many.

As for our "luxury" items, fine diamonds and beautiful jewelry, isn't it the American reward for achieving success to be able to purchase such pieces? It does not strike me as American to charge people at an uneven rate, penalizing jewelry lovers and not taxing lovers of fancy cars, vacations, summer homes and the list goes on. You would only be urging those who are going to buy fine pieces of jewelry to look to other countries for their purchases. We already lose sales to people shopping for jewelry when taking cruises in foreign waters or traveling in foreign lands. This tax would make more and more people consider this option. I am confident you agree with me that our economy does NOT need to watch any more of our U.S. dollars spent elsewhere. People will not give up their jewelry, they will only look for new ways to escape this law. Please do not force our customers away.

I urge you to vote down this tax which would unfairly point a finger at our jewelry industry and not even raise the revenue needed. The 1987 Joint Committee Staff Report , we were told, estimates that a "10 percent tax on jewelry over $100 in value would raise only $200 million in 1988. This would meet only one percent of the Ways and Means Committee's 1988 revenue target."

If our guild may answer any questions or be of any assistance, please call on us. We anxiously await a reply to our concerns.

Respectfully,

Jan Fergerson

Jan Jones Fergerson, Certified Gemologist Appraiser
President, Southeastern Guild, American Gem Society

REGISTERED JEWELERS
CERTIFIED GEMOLOGIST APPRAISER
ACCREDITED GEM LABORATORY

NBS
NATIONAL BRIDAL SERVICE

TELEPHONE
(404) 291-8811

Ford, Gittings & Kane
JEWELERS
312 Broad Street
Rome, Georgia 30161

August 10, 1987

The Honorable Dan Rostenkowski
2111 Rayburn House Office Building
Washington, D. C. 20515-1306

Dear Sir:

As a member of the jewelry industry for more than 45 years, I wish to add my name to opposition of the proposed 10% tax on jewelry. We paid this tax for more than 20 years to help pay for the World War II war effort and we did it mostly without complaining.

This discriminatory and unfair tax burden on the already beleaguered jewelry industry will cause more and more decline in employment in an industry which has lost 7500 jobs over the past 10 years. We will stand to lose a larger market share of jewelry sales to the already booming offshore and foreign market sales. The jewelers and employers will lose and our government will lose more and more tax dollars with a much larger percentage of jewelry sales going out of the country. Our balance of trade deficit will grow larger. Any tax which causes a decline in the United States market for jewelry will inevitably result in a further decline in employment. It seems to me that all consumer products should be taxed, which would result in a much greater revenue without being discriminatory to one industry.

In todays world most people find watches and jewelry to be a necessity. Certainly, everyone purchases jewelry, not just the wealthy. Items like caviar, silk scarves, English shoes and designer dresses are luxury items more than moderately priced jewelry.

As an independent jeweler of many years standing and an employer of quite a few tax paying citizens, I feel very strongly that an excise tax such as the 10% being proposed will have a very adverse reaction on my particular business and a great number of other jewelry businesses in this great country. It is precisely because of the burdensome inefficient and discriminatory nature of a jewelry excise tax that congress repealed it in 1965.

Please do what you can to prevent the congress from taking two steps backward by instituting this burden on our jewelry industry.

Sincerely,

Joseph C. Gittings, President
Ford, Gittings & Kane Jewelers.

JCG:sj

TEL. (212) 206-7710

G.B.Rinegold inc.

Fine Jewelry Manufacturers

39 WEST 19TH STREET, NEW YORK, N.Y. 10011

July 31, 1987

Robert J. Leonard
Chief Tax Counsel
Committee On Ways & Means
1102 Longworth House Office Bldg.
Washington , D.C. 20515

Dear Sir:

We would like to express our strong opposition to the proposed luxury excise tax on jewelry.

We have been in business for many many years and we have never in our history felt such intense pressure from imports as we are now having. We have cut our prices and profits drastically and even that did not enable us not to experience the largest layoff in our company's history. An added tax would serve a devastating blow to an industry that is already extremely hard hit by import competition.

In view of this and the fact that the proposed revenue is a small percentage only of the total package we urge you to oppose this tax on the Jewelry industry.

Sincerely,

G.B. RINEGOLD, INC.

Barry B. Fekete
National Sales Manager
BBF:rn

JMG
JEWELRY MANUFACTURERS GUILD INC

July 13, 1987

Robert J. Leonard
Chief Tax Counsel
Committee on Ways & Means
U.S. House of Representatives
1102 Longworth House Ofc Bldg
Washington, D.C. 20515

Dear Mr. Leonard:

I would like to take this opportunity to address the Committee as to my opposition to the proposed luxury excise tax on jewelry and other related items as I was not in attendance to testify at the hearings July 7-9.

Any excise tax added to the jewelry industry at this time could have a very serious adverse impact on American manufacturers and retailers for the following reasons:

1. The intention of this tax is to impose a luxury tax on wealthy individuals. I do agree that jewelry is a luxury item. However, a wealthy individual, if he wishes to purchase jewelry items, can find a way to do it without paying the luxury excise tax by simply travelling overseas and spending our dollar outside the United States, further deteriorating our trade balance.

2. If the excise tax is imposed as proposed, I forsee the tax will affect the low to medium income people who must purchase their jewelry for such important events as marriage, anniversary celebrations, etc. These kind of cultural events are not, in my opinion, considered luxury.

3. As reported by the Joint Committee on Taxation, the revenue from jewelry and other related items could be $200 million in 1988, which represents only 1% of the revenue target as stated by the Ways and Means Committee.

I urge you to exempt and relieve our small jewelry industry from such an unnecessary hardship. It could be the last blow on the existence of the American jewelry manufacturer, who fights to exist now in the continuous flow of imports.

Thank you for your consideration.

Sincerely,

Moshe Pereg
President

cc:Committee on Ways & Means

A Nonprofit Organization Serving the Manufacturer and the Jewelry Industry

P.O. Box 46099 • Los Angeles, CA 90046 • (213) 622-7373

Similar letters were submitted by the following:

Albert Lipten Designs et Cie. Ltd., Albert Lipten, President, New York, N.Y.
Aurafin, Steven L. Hansen, Vice President-Finance, Hollywood, Fla.
Kaspar & Esh, Stanely H. Sternberg, President, Long Island City, N.Y.
I.B. Goodman Company, Inc., Jack Beck, President, Cincinnati, Ohio
Marquesa Jewelry, Inc., Kirkor Bardisbanyan, New York, N.Y.
MOBA Jewelry Corporation, Seymour L. Moss, President, New York, N.Y.
Pioneer Diamond Corporation, Cindy J. Slainas, Office Manager, Houston, Tex.
Ravel, Inc., Michel Hajmowicz, Vice President, Clearwater, Fla.

July 17, 1987

House Committee on Ways and Means
U.S. House of Representatives
1102 Longworth Office Building
Washington, DC 20515

We respectfully request that you stop consideration of a 10% Federal tax on jewelry. This excise tax is no only unfair, but would prove a nightmare for the Treasury to enforce.

The Congress would assign itself an impossible task to distinguish between an individual's necesseties and luxuries. Can an everyday wrist watch be considered a luxury? Is the Congress ready to augment the financial difficulties of a newlywed couple by requiring that they pay ten percent more to practice a tradition as simple as wedding rings?

An excise tax on jewelry would be a great burden to many small businesses. Adding a tax of this magnitude to items that are already severely taxed at the state level would cripple many concerns and possibly cause them to fail. Not only would the Treasury no longer collect this excise tax, but it may also lose millions of dollars of income tax revenue generated by these enterprises.

When the Congress repealed the selective excise tax on jewelry in 1965 (22 years after the automatic repeal was proposed to go into effect) the Ways and Means Committee noted that excise taxes were a source of undesirable descrimination:

> "These selective excise taxes tend to reduce sales and therefore reduce income and jobs in industries that produce the taxed goods. In these ways, selective excise taxation results in arbitrary and undesirable distortion in allocation of resources and in this manner interferes with the free play of our competitive market."

Please review the practical wisdom that history has to offer and eliminate this fallacious revenue generating measure.

George N Sawyer
George Sawyer Design

375-1749

Identical letters were submitted by the following:

Murphy Design, Ms. Becky Kruger, Minneapolis, Minnesota
Murphy Design, Mr. Patrick T. Murphy, Minneapolis, Minnesota

G M E

1600 Howe Avenue
The Arden Howe Plaza
Business Center
Sacramento, CA 95825
916 925 6711

August 10, 1987

Dan Rostenkowski
Chairman, Ways and Means Committee
House Office Building
Washington, D.C. 20515

Dear Representative Rostenkowski:

I am strongly OPPOSED to the possibility of a jewelry excise tax, which is being considered in the House Ways and Means Committee.

This is a very unfair way to raise revenue. This tax would be an undue hardship on all jewelers who are already having a difficult time making a profit because of such a high overhead in this business. Jewelry Block Insurance has skyrocketed in the last few years and this cost must be passed on to the consumer. An extra 10% on every purchase would be a tremendous burden on not only the jeweler, but the consumer.

Sincerely,

Liz Addobati

Identical letters were submitted by the following, all employees of GME, Sacramento, California:

Ms. Alison Birch
Mr. Elmore O. Diehl, Jr.
Mr. Gary L. Thomas
Ms. G. Marilyn Thomas, President

Harvey J. Goldberg

707 EAST HACKBERRY DRIVE
ARLINGTON HEIGHTS, ILLINOIS 60004
PHONE 312/394-1444

July 24, 1987

HOUSE COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
1102 LONGWORTH OFFICE BUILDING
WASHINGTON, D.C. 20515

TO WHOM IT MAY CONCERN:

Regarding the proposed 10% Federal Tax on Jewelry now in discussion, please be advised that we are vehemently opposed to same ... because as Jewelry Manufacturers' Representatives it will enormously affect both the Jewelry profession and our livelihood.

The following members of my immediate family are all voters and taxpayers:

HARVEY J. GOLDBERG
LEE A. GOLDBERG (Wife)
LORI E. GOLDBERG (Daughter)
Gail D. Goldberg (Daughter)
Joyce & Paul Somerstorfer (Daughter and Son-In-Law)

Respectfully yours,

Harvey J. Goldberg
HARVEY J. GOLDBERG

GUNTHER MARX JEWELRY CO.
1125 BRYN MAWR AVENUE
CHICAGO, ILLINOIS 60660
Telephone: 271-6263

August 25, 1987

The Honorable Dan Rostenkowski
Committee on Ways and Means
1102 Longworth House Office Bldg.
Washington, DC 20515

Dear Mr. Rostenkowski:

It has come to my attention that your committee is considering legislation to impose an excise tax on jewelry and watches.

I am old enough to have been in business when the tax imposed in World War II was in force. It was then a most burdensome imposition on the small retailer. It would be no less burdensome now.

It would also be discriminatory. Not only will it reduce our sales volume, since customers will seek to buy articles which are not taxed, but it will also add to the cost of record keeping.

Thank you for your consideration.

Sincerely,

Gunther Marx
Jeweler

H & J BLITS JEWELERS

July 13, 1987

House Ways & Means Committee
1102 Longworth House Office Building
Washington, DC 20515

Dear Sir,

As a retail jeweler located in New York City, we were appalled at the proposed reinstatement of a 10% jewelery excise tax.

This last war-time tax was appealled in 1965, as you know. Is this new war the United States vs legitimate jewelers?

The reinstatement of this tax will give a very unfair advantage to unscrupulous jewelers who do not report their sales at all, as they do a "cash" business. Should this tax be reinstated, and then added to our city and state sales taxes, it will put legitimate jewelers out of business.

In addition, the tax will ruin the U.S. central market for diamonds, as business will shift to other markets. The tax will reduce sales and cause unemployment in the jewelery manufacturing, distribution and retail trade. The tax will shift demand from local jewelry products and direct consumer expenditures to other products which may well be imports. The tax would be very difficult to collect, enforce or administer. The tax is highly discriminatory, and the congressmen will lose votes over this issue.

Sincerely,

Harold J. Blits

Sheldon E. Rosenfeld

Harold Blits 49 West 57th Street New York 10019 (212) 980-8778 Sheldon Rosenfeld
ESTABLISHED IN 1914

H. D. Bean Jewelers

123 EAST MAIN STREET • CARMI, ILLINOIS 62821 • TELEPHONE 618-382-8170

August 24, 1987

Senator Dan Rostenkowski
2111 Rayburn House Office Bldg.
Washington, D.C. 20515

Dear Senator,

As a jewelry store owner, I must urge you to reconsider your position on the proposed excise tax on jewelry. The jewelry business as a whole is a very small segment of our nations economy and most jewelry stores are small, family-owned stores. To impose a tax on only a certain part of the business segment is grossly unfair and discriminatory.

This tax would make a jewelry purchase less desirable to a customer. They could purchase other luxury items such as furs, purfumes, or electronics products and get much more value for their money. Therefore the whole jewelry industry would suffer a loss of business.

Please do not allow this selective tax to be passed. Surely some fairer means of raising revenue could be found.

Sincerely,

Thomas R. Bean

HILLER JEWELRY CO. INC.
"Exclusively Wholesale"
ONE-LOVE
DIAMONDS

Diamonds
Silverware • Watches • Jewelry
300 Audubon Bldg.
Phone 525-5181
931 CANAL STREET
NEW ORLEANS, LA. 70112

July 13, 1987

Honorable Dan Rostenkowski
House of Representatives
Chairman
House Ways & Means Committee
1102 Longworth
House Office Building
Washington, D. C. 20515

Dear Sir:

It has been called to my attention that the House Ways and Means Committee is contemplating a retail tax on various items of jewelry, precious stones, etc.

What a big mistake that would be! The tax would divert the buyer from this market into other markets that are not taxed and would cause unemployment in jewelry manufacturing and distribution. This tax would be highly discriminatory against a certain group of business people and would be very costly to collect. I urge you to defeat this proposed tax.

All good wishes.

Yours truly,

HILLER JEWELRY COMPANY, INC.

Jonas Hiller

Jonas Hiller

JH:JB

DGHines
GOLDSMITH

#50 CENTER ST
P O BOX 2737
JACKSON, WYOMING 83001
(307) 733 5599

July 21, 1987

House Committee on Ways and Means
U. S. House of Representatives
1102 Longworth Office Building
Washington, D.C. 20515

Dear Sirs:

This letter of concern is in reference to the proposed 10 percent Federal Excise tax.

It is truly beyond me why the Federal Government has to pick on a certain industry to tax to death. I pay large portions of IRS taxes every year, employee taxes in the form of 940's and 941's, etc., etc.! At this time I feel like 90% of my bookkeeping time is spent doing paperwork for the government.

As a small jewelry store struggling along to make ends meet for the last 17 years I do feel that this tax is DISCRIMINATION and would be terribly burdensome. Taxes of this nature only lessen the economic stability of this country; not enhance it or reinforce it.

Is OUR government REALLY looking out for the businesses, small and large, that keep the economy in this country stable and growing--or is it looking for an easy out and an industry to kill??

I suggest you take the jewelry industry seriously because NONE of us are going to let you slip through this ridiculous tax proposal.

Carolyn Hines
for Hines Goldsmiths, Inc.
Larry M. Gorchesky
Jan Jensen-Case

Carolyn Hines

873-5694

HOFERT *Jewelers, Inc.*

2876 DELAWARE AVENUE • KENMORE, NEW YORK 14217

August 8, 1987

House Ways & Means Committee
Washington, D.C.

Gentlemen,

We are unalterably opposed to any form of luxury tax being imposed on jewelry. It is our opinion this would do more harm than good to the country.

If you wish to raise additional capital by sales tax, we suggest you use Lido Iacocca"s idea of an "across the board" 1% sales tax. The poor man and the rich man would equally be hit by this tax --each would contribute according to his expenditures.

Secondly, Iacocca says to cut each department's budget by ten to twenty per cent -- this would cut out the fat, and not jeopardize the efficiency of the department.

If Iacocca can save Chrysler from bankruptcy, we suggest you use his genius to cure our financial ills. He is a true American.

Very truly yours,

William J. Hofert
Secretary-Treasurer

JACK LEWIS, INC., *Fine Jewelry and Silverware*

ILLINOIS HOUSE, BLOOMINGTON, ILL., 61701, PHONE 829-7669

8-28-87

Senator Dan Rostenkowski
Chairman House Ways & Means Comm.
Washington, D.C. 20515

Dear Senator:

I share the concern, I believe, of all jewelry manufacturers and retailers about the effects of the proposed luxury tax on the many American people who depend on our industry.

I am the manager of a privately owned, two store retail jewelry operation. The effects of this proposed tax would be devastating. There is just not that much profit in the retail business for us to meet the additional expendatures involved with collecting such a tax. Customer reaction will drive their discretionary dollars towards other purchases and what purchase they do make will be adjusted to meet their dollar. In other words, the customer has a set amount of money to spend, with the tax in place the jeweler will suffer a 10% reduction in total sale price and a 20% or more reduction in profit.

The general reaction of the public towards our business would be entirely negative. We have shoppers now that drive over 40miles to save a 1% city tax on major purchases. You can imagine what a 10% tax would do to these customers. These customers and others would no longer purchase jewelry.

This proposed tax would reduce our sales and our incomes. If the effect is as bad as anticipated we would be forced to reduce sales staff and support personel, thus stimulating unemployment.

This tax is selectivly discriminatory. You are imposing an unfair tax on a select industry that does not have the voting force of other manufacturing and sales industries.

I urge you to please give this your serious consideration and vote against this discriminatory and damaging tax proposal.

Sincerely,

Mark L. Meins

Mark L. Meins

Jeffrey Jewelry Mfg. Co.

MANUFACTURING AND REPAIRING

July 15, 1987

House Committee on Ways and Means
U.S. House of Representatives
1102 Longworth Office Building
Washington, D.C. 20515

It has come to our attention that there is an excise tax on jewelry being considered. I would like to take this opportunity to express my opposition to this 10 percent federal tax. The jewelry industry should not be singled out for additional taxation.

Jeffrey A. Silver,
President

12 SOUTH SIXTH STREET • SUITE 259 – PLYMOUTH BLDG. • MINNEAPOLIS, MINNESOTA 55402 • (612) 338-0708

JIC

Jewelry Industry Council

Suite 801 • 411 Fifth Ave. • New York, NY 10016 • 212/685-1140

August 5, 1987

Mr. Robert J. Leonard
Chief Counsel
Committee on Ways & Means
U.S. House of Representatives
1102 Longworth House Office Bldg.
Washington, DC 20515

Dear Leonard:

I'm writing to you on behalf of our 400 jewelry manufacturers and 500 jewelry retailer members.

Our concern is with the proposed "Luxury Tax" on jewelry and watches retailing over $100.

We consider the passages of an excise tax on jewelry to be unfair and discriminatory, to say nothing about burdensome and inefficient. If memory serves, it was for those very reasons that congress repealed the excise tax on jewelry and watches in 1965.

We would ask that you and the Committee seriously consider the unfairness of such a tax. When we consider the cost to government for administering a tax that will only raise 200 million, it just doesn't make good business sense.

We greatly appreciate your consideration in this matter.

Yours truly,

Gerry Hansen
President

GH:jt

JEWELS BY
angelo
11114 New Street, Downey, California 90241
213-862-6283
TELEX: 676631-01

July 21, 1987

The Honorable Dan Rostenkowski
House Committee Chairman
House Committee on Ways and Means
2111 Rayburn Office Building
Washington, D.C. 20515

Dear Mr. Rostenkowski:

As an active jewelry industry member for the past 40 years, I have seen the damaging results of a jewelry excise tax on our industry in the past, and I'm opposed to even the consideration of such a tax in the future. With the attention now given go GSP countries, who are using child labor, do not have to answer to OSHA regulations, and some who are government subsidized, we have now lost 30 percent of our production to off-shore companies. To add an excise tax on jewelry would be the same as putting another nail in our coffin.

Jewelry is not a luxury. We in the jewelry industry provide the "badges of achievement" for society. The American dream stays alive because of our unique opportunity and the recognition of accomplishments by our citizens. The jewelry industry fills the need for suitable, lasting items for this recognition. I urge you and your committee to reject any proposal which would implement an excise tax on jewelry products.

Very truly yours,

A.R. Cardono
President

Past Director:
Manufacturing Jewelers & Silversmiths of America

Current Director:	Member:
Jewelry Industry Council	Jewelers' Vigilance Committee Cultured Pearl Association of America California Jewelers Association Jewelers of America

Past President:
Jewelers' 24 Karat Club, Southern California

Precious Jewelry Manufacturing

San Francisco, Los Angeles, San Antonio, Pittsburgh, Denver, Honolulu, Hong Kong

Kunzelman Bros.
MANUFACTURING JEWELERS AND IMPORTERS 315 North Ninth Street Suite 209c St. Louis, Missouri 63101 (314)241-9562

Representative Dan Rostenkowski, III
House Office Building
Washington, D. C. 20515

Dear Representative Rostenkowski,

In the last eight years we have watched our gold inventory go from $850 down to $300 and now back to $450. And diamond prices plummet from $60,000 to $9,000 and now back to $14,000 for the finest 1 carat diamond. We have lost many manufacturers, distributors, and retailers along the way. And many employees.

Now we learn that the Ways and Means Committee is considering a luxury tax on jewelry. Frankly, that would be a devastating blow to our already depressed industry.

The American people were certainly counting on Congress to reduce our budget deficit via the Gramm-Rudman guidelines. We don't want increased taxes of any kind. Please vote against any new taxes.

Respectfully submitted,

Ronald D. Kunzelman

PRECIOUS GEMS • DIAMONDS • WATCHES • JEWELRY • GIFTS

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AGS
MEMBER
AMERICAN GEM SOCIETY

September 1, 1987

Dear Sir:

As the owner of a small, independent retail jewelry store, I am horrified at the prospect of an excise tax on jewelry. I am an active member of the Georgia Jewelers Association, serving on its Board of Directors for years, and currently also an officer. I am past president of the Southeastern Guild of the American Gem Society.

This proposed tax discriminates against our industry. Why penalize those who work hard and can afford to give themselves an item of jewelry? Please realize that the main part of our sales are not even in a price range considered "luxury" when compared with items such as furs, imported cars, and designer items.

The burden to jewelers and to the government in collecting, recording and transmitting this tax could be the straw that breaks the camel's back. And all for a relatively small amount of revenue.

The jewelry industry has lost 7,500 jobs in the past ten years. I feel that this tax will cause a further decline in the market for jewelry, as our customers may decide to spend their hard-earned dollars for other purchases that are not subject to the tax.

Thank you for your time and prompt attention. Please consider my letter in making your decision.

Sincerely,

Ben DiGirolamo
Certified Gemologist,
A.G.S.

LEO HAMEL CO.

8-6-87

Dan Roslenkowski,

My name is Lisa Hamel. I work at my brothers jewelry store Im writing to protest this potential tax on Jewelry this is a treat to our industry. I oppose this tax!

thank you

Lisa Hamel

3145 B El Cajon Blvd. • San Diego, CA 92104
Leo Hamel (619) 281-0125

LESTER LAMPERT

701 North Michigan Avenue
Chicago, Illinois 60611

312/944-6888

July 27, 1987

Robert J. Leonard
Chief Tax Counsel
Committee on Ways & Means
U. S. House of Representatives
1102 Longworth House Office Bldg.
Washington, D. C. 20515

Dear Mr. Leonard:

As a businessman in the Jewelry Industry, I feel the proposed luxury excise tax on jewelry should be vetoed.

The jewelry industry has been hit "hard" with the increase of the sales tax to begin with, and another additional tax would hurt our industry drastically.

In my opinion, as the opinion of other jewelers, jewelry is not always a luxury item and, if this tax is passed, the jewelry industry will be affected greatly.

Again, I repeat, please try to veto the passing of this bill.

Very truly yours,

LESTER LAMPERT, INC.

David Lampert
Vice President

DL/sz

maico

Maico Industries, 129 First Avenue East, Roselle, New Jersey 07203
1-800-526-4091 • 201-241-1211

August 24,1987

Robert J. Leonard
Chief Tax Counsel
Committee on Ways and Means
U.S. House of Representatives
1102 Longworth House OFC Bldg.
Washington, D.C. 20515

Dear Mr. Leonard:

I strongly object to the proposed luxury excise tax on jewelry and other related items and ask that you oppose such a tax, for the following reasons:

1. The American Jewelry Manufacturers are presently fighting to exist with the continuation of foreign competition. An excise tax would have a serious adverse impact, only creating unnecessary hardship for our small jewelry industry.

2. A luxury tax would not tax the wealthy individual as it is intended. Wealthy individuals would purchase more of their jewelry while traveling overseas. Thereby, avoiding the tax and further deteriorating our trade balance.

3. The lower and middle class population, who purchase jewelry only for weddings, anniversaries and special celebrations, would be affected by a jewelry excise. Jewelry purchase for such events are not luxury items.

4. The estimated $200 million revenue, from 1988 that would be received from the proposed jewelry excise tax, represents only 1% of the revenue target as stated by the ways and means committee. This increase in revenue could be more than offset by the reduction in revenue from Federal Income taxes, both corporate and personal, due to the lower corporate profits and fewer Americans employed.

5. An excise tax on Jewelry would be very burdensome and costly to adminster, both for the small business and the government. Even a tax on items over $100 would need to be collected and accounted for on literally million of transactions at several hundred thousand retail outlets, many of which are Mom and Pop stores.

Thank you for your consideration,

Yours truly,

Michael Schachter
(President)
MAICO INDUSTRIES INC.,

MENENDEZ JEWELERS, INC.
MANUFACTURER, IMPORTER AND WHOLESALER OF 14 KT. & 18 KT. GOLD JEWELRY
117 N. E. FIRST AVENUE - SUITE 800 - MIAMI, FLORIDA 33132
PHONE: 358-5020 OR 379-8550
TOLL FREE 800 - 327-6706

House Committee on Ways and Means
U. S. House of Representatives
1102 Longworth Office Building
Washington, D.C. 20515.-

Miami, July 20 1987.-

Gentlemen:

By these means we wish to register our objection to the 10% Federal excise tax on jewelry.

We have been in the jewelry business for the past 30 years and an excise tax on jewelry would be extremely burdensome for small businesses and would be costly to administer.

The imposition of a luxury tax will distort purchase decisions in the market place making it more difficult to make sales.

Very truly yours,

MENENDEZ JEWELERS INC.
Jose A. Menendez (President).-

"LARGEST ASSORTMENT OF IMPORTED DIAMOND RINGS TO THE TRADE"

Michael Werdiger, Inc.

3[illegible] WEST 45TH STREET ♦ NEW YORK N Y 10036 ♦ TEL 212 869 515

COMMITTEE ON
RECEIVED
SEP 3 1987
WAYS AND MEANS

August 27, 1987

The Honorable Dan Rostenkowski
Chairman House Ways and Means Committee
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Chairman:

We strongly oppose the new proposed Luxury Tax on jewelry and watches. If enacted, a relatively small amount of revenue would be raised. In addition, the administrative cost for both the government and private sector would greatly diminish the actual net revenue realized.

Very truly yours,

Michael Werdiger, Inc.

Alan F. Kleinberg

AFK:bes

♦ Diamond Abrasives Corporation

MOMAYA, INC.
217 N. McLEAN BLVD., SUITE 1A
ELGIN, ILLINOIS 60120, U.S.A.
312-742-1200 CABLE: MOMAYA

July 18, 87

Dear Representatives,

This letter is just to inform you that the "10 percent Federal Tax on Jewelry" you are considering I find it quite unfair. We are also experiencing hard to compete with imported jewelry prices. I feel increasing duty on imported goods will be betterway to balance Federal deficit.

Sincerely,
Andy Momaya

1987

August 14, 1987

Dear Congressman Rostenkowski:

The below people are jewelers from Montana and Wyoming who urge you and the Ways and Means Committee to consider the cost of the Jewelry Excise Tax in terms of money raised against administrative costs. When the tax was in effect before IRS people have said that the cost was greater than the amount of money raised.

It is also a highly discriminatory measure. Why tax jewelry when there are luxury items in almost every other retail line - including foods, appliances, automobiles and homes? It will reduce sales and cause unemployment in jewelry manufacturing, distribution and retailing. The end result will not achieve tax dollars without a higher loss in many other economic areas.

Thank you very much for your concideration of our views COMMITTEE ~~this~~ proposal.

Sincerely

Peggy Lane
Mark Lane
James N. Brown
Ronald D. Neibauer
Richard J. Growney
Pat Loos
Janet Johnson
Mark Perkowski
Rhonda Lee
Shirley A. Keenan

James Keenan
Lillian M O'Neil
Ron Kraft
Michael L. Burke
Thomas L. Brown
Juanita C Brown

Kristen L Cox

MONTANA WYOMING JEWLERS P.O. Box 2276 Billings, MT 59103

New Address:
NAFCO GEMS LTD.
10427 N. Scottsdale Rd. #204
Scottsdale, AZ 85254
[illegible] 998-3393

NAFCO GEMS LTD.
5020 N. 20TH STREET (SUITE 202) • PHOENIX, AZ. 85016 • TEL. (602) 248-9233 • TOLL FREE (800) 528-4490
MEMBER AMERICAN GEM SOCIETY, AMERICAN GEM TRADE ASSOCIATION, INTERNATIONAL COLORED GEM STONE ASSOCIATION

August 3, 1987

Mr. Robert J. Leonard
Chief Counsel
Committee on Ways & Means
U.S. House of Representatives
1102 Longworth House Office Bldg.
Washington, D.C. 20044

Dear Mr. Leonard:

We at Nafco Gems Ltd. wish to strongly voice our opposition to the proposed 10% retail excise tax on jewelry and gemstones as outlined to the HOuse Ways and Means Joint Taxation Committee.

Your efforts to vote this tax down would be greatly appreciated.

Sincerely,

Roland Naftule
President

RN:nz

8 RUE DES MARAICHERS, 1211 GENEVA, SWITZERLAND - TEL. (022) 28-27-22

serving the USA...
NATIONAL BOX
& DISPLAY
INC

418 East 4th
Spencer, Iowa 51301

800-251-6008
712-262-1455 IOWA ONLY

July 17, 1987

House Committee On Ways and Means
U.S. House of Representaives
1102 Longworth Office Building
Washington, D.C. 20515

It is our understanding that the House Committee On Ways and Means is considering a 10% Federal Tax on jewelry.

National Box and Display Inc. of Spencer, Iowa would like to go on record as opposed to this 10% tax on jewelry to reduce the Federal Deficit. A tax of this nature, as we see it, would put an unnecessary burden on the retail jewelry industry. Keeping track of all sales deemed "necessities" or "luxuries" would be a ludicrous task for the individual retailer.

Collecting the tax from the smaller retail stores would entail a larger cost for the IRS than would be the receipt in some instances.

Why tax small businesses such as us, when large corporations get by with paying only $100.00 to $1000.00 in taxes each year?

In closing, my personal feeling is that this tax will tend to reduce sales. Reduced sales means loss of jobs and the loss of jobs causes unemployment. Unemployment, by the way, costs the American Government money. Seems to me this is the wrong way for the American Free Enterprise to go.

Concerned for our industry,

National Box and Display Inc.
418 East Fourth Street
Spencer, Iowa 51301

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4119 Girard Avenue North
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July 20, 1987

Robert J. Leonard - Chief Counsel
1102 Longworth Office Building
Washington, D.C.

Dear Mr. Leonard:

I wish to lodge a strong protest against the proposed 10% tax on jewelry.

This would be a very discriminatory tax that could not help but harm the entire jewelry industry. This tax added to state and city sales taxes would add a great deal to the bill on even a modest jewelry purchase. It would certainly have a negative effect on sales, and could quite possibly throw the jewelry industry into a depressed state.

I would hope the House Committee looks very carefully at this bill, and will come to the same conclusion those of us in the jewelry business have: namely, that it is a bad idea at a bad time that singles out one segment of industry unfairly.

Thank you for taking the time to read my comments.

Sincerely,

John G. Neiss

John G. Neiss

Rapaport Diamond Report
15 West 47th Street, New York, N.Y. 10036 Tel: 212-354-0575 Telex: ITT 428-349

To: The Honorable Dan Rostenkowski
Chairman: House Ways and Means Committee
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

July, 8, 1987

re: Written Testimony on Proposed Luxury Excise Tax

Dear Committee Members,

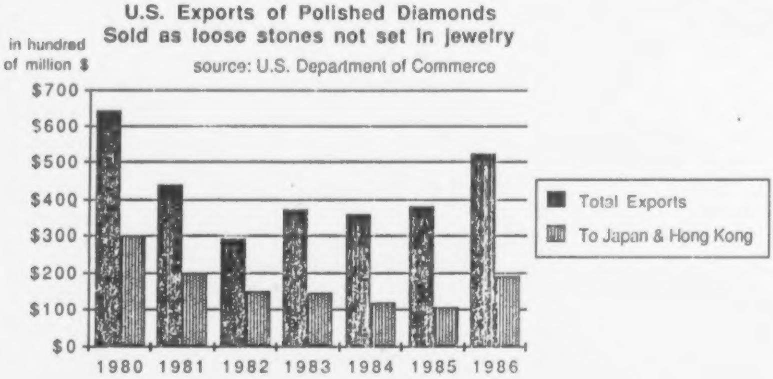
I am an expert on the diamond industry and have been publishing a detailed newsletter on the diamond markets since 1978. I offer this testimony on behalf of the thousands of individuals that are dependent on New York's 47th Street Diamond Market to earn their daily bread.

The world diamond market is organized about several major diamond centers. These centers are Antwerp, Belgium; New York, USA; Ramat Gan, Israel; and Bombay, India. Other less important centers do not have cutting capabilities, but they are trying to enter the world market as distribution centers. They are or have been London, England; Geneva, Switzerland; and Hong Kong. Each diamond center specialized in a different type of activity. Israel and India cut small inexpensive stones, due to their low cost of labour. Belgium is an important clearing market for rough diamonds. **New York is the worlds major market for large, important and expensive diamonds.**

The success of the New York diamond market is entirely dependent on our ability to attract diamond buyers to New York. **The wholesale diamond market does not operate in a vacuum and cannot function without an active and viable local retail trade.** The New York dealers and auction houses have worked extremely hard to bring buyers to New York. We have succeeded and have beat out Geneva, London, and Hong Kong as the world center for large stones. In fact as you can see in the graph on the reverse side, New York has increased our exports to Japan and Hong Kong by 78% in 1986. These increases in foreign demand are just the beginning in a new wave of foreign demand for New York diamonds. As foreign countries acquire great wealth their demand for expensive diamonds increases exponentially. The richer Japan gets the more diamonds the Japanese will buy. **Will the Japanese be buying these diamonds in New York or Switzerland?**

(continued Reverse Side)

The proposed legislation would absolutely destroy the New York diamond markets ability to compete in the international diamond marketplace. Large diamond buyers will not pay any excise tax, they will simply buy their diamonds in Switzerland. It is critical to understand that if consumers avoid the U.S., the wholesalers, dealers, cutters, designers, jewelers, and auctioneers will be forced to leave the U.S. market.



The New York market handles about $3 billion of loose polished diamonds annually. Of this $3 billion, $525 million were exports that directly improved the U.S. balance of trade. $191 million went to Japan and Hong Kong, a 76% increase over 1985 exports to Japan and Hong Kong of $108 million. Given the current state of the diamond markets it is reasonable to expect diamond exports to increase and reach $1.5 Billion by 1990. It is important to note that this information and graph relate only to loose polished diamonds. Demand for U.S. set jewelry has also been very strong and is increasing. Sales by the top three New York auction houses alone topped $100 million this past year and about $50 million of this were net exports.

If the proposed excise tax is adopted we may expect the following:
- severe unemployment in the U.S. diamond and jewelry industry.
- higher prices for almost all imported diamonds as N.Y. becomes a secondary market.
- loss of current and future potential export sales of diamonds and jewelry.

Accordingly, I sincerely urge the committee not to adopt the proposed legislation. If I can be of any service to the committee, answer any questions, or provide additional written or oral testimony, please contact me.

Respectfully yours,

Martin Rapaport
Publisher: Rapaport Diamond Report

7-7-87

Dan Rostinkoski
Longworth Bldg.
Ways and Means
Washington, D.C.

Raymond Jewelers
1134 New Britain Ave.
West Hartford, CT 06110

Dear Mr. Rostinkoski,

As active members of the jewelry industry, we oppose the tax option including a 10 (ten) percent tax on jewelry, various precious and semi-precious stones, watches, clocks, sterling silver, silver-plated, gold or gold-plated holloware and flatware, and other items.

Sincerely,

The entire staff of Raymond Jewelers
Fine Jewelers since 1952

c/file

RMJA
ROCKY MOUNTAIN JEWELERS ASSOCIATION OF COLORADO AND EASTERN WYOMING

HELEN SHERER
EXECUTIVE SECRETARY

P.O. Box 24105
Denver, Colo. 80224
303/757/2134

PRESIDENT
Diane Lancaster
Robert Yacovetta Jewelers
(303) 671-8024

VICE PRESIDENT
Jennie Ellis
Ellis Jewelry, Inc.
(303) 641-1300

SECRETARY TREASURER
Teri Baertlein
Bench Works
(303) 591-4724

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Cubitto's Fine Jewelry
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Jay Fleming
Jay Fleming Jewelers
(303) 848-1925

Lou Hassoun
Schley Jewelers
(303) 232-3121

Greta Luttuer
The Jeweler
(303) 674-5357

Norman McQueen
Pinetree Jewelers
(303) 841-2666

John Purvis
Purvis Jewelers
(202) 233-2708

Lynn Hamann-Roberts
Sartor-Hamann
(303) 226-2917

Debby Sherrerd
Rominger Jewelry, Inc.
(303) 522-2587

member
JEWELERS OF AMERICA, INC.

July 9, 1987

Ways and Means Committee
1102 Longworth Bldg.
Washington, DC 20515

To Whom It May Concern:

As President of the Rocky Mountain Jewelers Association of Colorado and Eastern Wyoming, I represent approximately 100 independent jewelry stores, as well as 50 related businesses.

I'm writing concerning the possible 10% luxury (excise) tax on jewelry proposal being considered by you.

An excise tax on jewelry would be extremely burdensome for small business and would be costly to administer. Collecting such a tax on each sale of a modest pair of earrings or a necklace would impose a crushing burden on retailers and would entail high enforcement costs for the IRS for a relatively small revenue pick up.

Congress assigns itself a proven impossible task, in terms of acting with fairness and equity, when it attempts to distinguish between an individual's necessities and luxuries. One could not fairly describe a $100 watch as a luxury item nor would one normally classify most reasonably priced jewelry as "luxury items."

At the time Congress repealed the selective excise tax on jewelry in 1965, the Ways and Means Committee noted that such taxes were a source of undesirable discrimination.

Please vote NO on this proposal!!

Sincerely,

Diane Lancaster

Diane Lancaster
President

Shaw
MILFORD PLAZA
JEWELERS OF MILFORD, INC.
163 CHERRY STREET • MILFORD, CONNECTICUT 06460 • (203) 878-6331

July 16, 1987

The Honorable Dan Rustenkowski
Chairman, House Ways and Means Committee
United States Congress

Dear Sir;

I am writing you with regards to the bill going through Congress concerning the 10 percent luxury tax on jewelery. This tax will not only damage the economy as a whole, but it will also put the small business men, such as myself, out of business.

Jewelery is cyclical, just as any other economy of scale. The factory manufactures the product for the wholesaler, who then sells it at retail price to its customers. With this ten percent increase, we will be losing a substantial amount of customers, which will in turn put hundreds, maybe thousands of factory workers out of work. This will decrease the overall spending volume in our economy.

Another point on this bill is the limits of a luxury item A one hundred dollar watch is a piece of jewelery, but why is it a luxury item when it is needed to get someone to work on time? Is an engagment ring a luxury item when it is the only way to signify such an event?

Maybe there is another solution to decreasing the National Debt? I think that an overall raise in taxes would help. Not a big raise but enough to make somewhat of a difference.

Please take my suggestions into consideration, and vote no on the imposed luxury tax.

I thank you for your time.

I Remain,

Mitchell S. Elovitz
Vice President, Shaw Jewelers Inc.

Shockey Jewelers
18 DOUGLAS AVE., ELGIN, ILLINOIS 60120 (312) 742-0113

August 29, 1987

Senator Dan Rostenkowski
Chairman House Ways & Means
2111 Rayburn House Office Bldg
Washington, D.C 20515

Dear Senator:

We understand that the Ways & Means Comm may soon propose a luxury tax on jewelry. Please consider what this could do to the jewelry industry. The majority of stores are small family owned and operated businesses. In 1965 a luxury tax on jewelry was REPEALED and it took years for the industry to rid itself of that unfair burden. Now the same industry is targeted for discrimination AGAIN !

If this type of legislation is introduced, we would like you to consider these "luxuries":

Foreign air fares
Electronic products (mostly imported)
Suits over $50
Shoes over $30
Dresses over $50
Autos over $10,000
Meals over $5
Furniture over ?
Carpeting over ? etc, etc, etc.......

It doesn't make sense, does it? But yet it would be more equitable than picking on one industry!

The jewelry industry has had some difficult times in the past few years. We are just now beginning to see some improvement. We do NOT need a discriminatory tax imposed on us!!

Catherine Shockey Russell Shockey
Catherine Shockey Russell Shockey

Silverman
JEWELERS CONSULTANTS, INC.

Sales Specialists and Consultants
To the Jewelry Industry

1065 Old Country Road
Westbury, New York 11590
(516) 333-4600

August 31, 1987

Congressman Daniel Rostenkowski
Chairman
House Ways & Means Committee
1102 Longworth House Office Building
Washington, DC 20515

Dear Congressman Rostenkowski:

There is a proposal in the House of Representatives to impose a 10% excise tax on most jewelry sales. We oppose this tax and believe that it will severely hurt jewelry manufacturers, retailers and wholesalers quite possibly to the extent that there will be no net gain in revenues to the Federal Government.

As consultants to the jewelry industry, we can tell you that there presently is a considerable dynamic change occurring in jewelry retailing. Because down town areas are giving way to malls, and new malls are replacing older malls, each store's piece of the pie is getting smaller. Old line down town stores, usually mom and pop establishments, are becoming marginal, and many are closing.

The proposed tax would certainly curtail buying on the part of the public, thus hurting jewelry retailers across the board and precipitating an increased rate of forced store closings and failures. This is also true for the major catalog showroom chains, most of which are struggling for their very existence and whose sales are generally 35% jewelry.

We also believe that the proposed tax discriminates against the jewelry industry. While there is competition among jewelers, most in the industry believe that jewelers are, in fact, competing for discretionary dollars that might go to electronics, vacations, furs, and other so-called luxury items. Taxing jewelry will give these other items an unfair advantage, and thus is discriminatory.

Still further, there is an ever-growing trend for the offshore manufacture and import of jewelry into the United States. The broad base of jewelry manufacturing in this country is being threatened by these foreign imports. The proposed excise tax would diminsh retail jewelry sales in this country, and thus make it harder for domestic manufacturers to maintain plant capacity and stay in business. Much of jewelry manufacturing is not automated, and jewelry manufacturers employ many workers throughout this country from all backgrounds. We would not like to see these manufacturers and their employees hurt by the proposed tax.

We urge you to investigate the ramifications of this proposed tax, both on a national level and in your own local area. We are convinced that when the facts are known, you will also do your best to oppose the passage of this tax.

Very truly yours,

SILVERMAN JEWELERS CONSULTANTS, INC.

Ronald H. Silverman
President

National Jeweler
A GRALLA PUBLICATION
THE COMPLETE NEWSMAGAZINE FOR THE JEWELRY INDUSTRY ☐ AUGUST 16, 1987

Organizations Rally to Fight Looming Excise-Tax Threat

By CINDY E. CORDERO
Contributing Editor

WASHINGTON—A possible excise tax of 10 percent on luxury goods, including jewelry, priced more than $100 at the retail level has prompted a campaign on the part of jewelry industry organizations to defeat such a tax.

The tax option was published by the House of Representatives' Ways and Means Committee as one of about 200 possible options to reduce the $174 billion federal deficit. Congress is legally committed to reducing the deficit by $19 billion by fiscal year 1988.

"The threat [of an excise tax] is very real," warns American Watch Association's executive director Emilio G. Collado in a press release. Indeed, the tax, if levied, could raise $200 million in fiscal year 1988, $400 million in 1989 and another $400 million in 1990, bringing a total of $1.1 billion in revenues over three years.

However, jewelry industry organizations like Jewelers of America and the New York State Jewelers Association argue that negative effects of such a tax would outweigh the raised revenue. A luxury tax would hurt an already depressed industry, burdening small businesses with tax collection, they argue.

Moreover, the tax would be costly for the Treasury Department to administer and could lead to tax evasion, they say. Both JA and NYSJA have recommended that their members write to Congress members who sit on the tax committee.

"It's a crisis," said Mich Roman, chairman, JA, New York. "These selective excise taxes tend to reduce sales and therefore reduce income and jobs in industries that produce the taxed goods. In these ways, selective excise taxation results in arbitrary and undesirable distortion in allocation of resources and interferes with the free play of our competitive market," JA's briefing notes to the industry read.

The Speaker of the House, James Wright, D-Texas, is said to support a luxury tax. Republicans, however, are against such taxes as a general rule, AWA's Collado said. "Quite a few members of Congress, mainly Republicans, have said 'don't bother coming [to testify]. I'm on your side,' " Collado told NATIONAL JEWELER.

The small chance of such a tax being levied is demonstrated by the poor attendance at the Congressional hearings. Only three representatives of the House Ways and Means Committee heard testimony from Robert Leeds, president, Jewelmont Corp., Minneapolis. But Collado believes if the industry becomes complacent, "a political bolt could come out of nowhere."

Nip It in the Bud

In addition, Democratic control of the House has made industry members wary. They want to "nip the threat in the bud," according to the AWA. To that end, after a two-year hiatus, the Jewelry Coordinating Committee, which was founded to fight a jewelry excise tax in 1982, was scheduled to reorganize at the JA show.

In the meantime, industry representatives have launched a campaign combining lobbying efforts, letter writing and testimony before Congress.

In his testimony last month before the House Ways and Means Committee, Leeds said a selective system of excise taxes places discriminatory tax burdens on the consumer and producers of the taxed products, and that they tend to reduce sales, incomes and jobs in the industries that produce the taxed goods.

Leeds argued further that the tax would "cause distortions in buying patterns...and discourage the purchases of jewelry in favor of other untaxed items." Indeed, Matthew Runci, executive director of the Manufacturing Jewelers and Silversmiths of America, told NATIONAL JEWELER that he felt many consumers would choose to buy an untaxed camera over a taxed piece of jewelry.

Other points Leeds made as a representative of the industry include the following:

- The tax would be costly to administer and burdensome both to the Internal Revenue Service and small businesses.
- A tax that only applies to the value of jewelry in excess of $100 retail would complicate administrative chores, widening avenues for tax evasion. To avoid collecting and paying tax on a pair of earrings over $100, they might be sold one at a time, the MJSA noted in a flash bulletin.
- The impact of the tax would fall on the same people who purchase already taxed cigarettes, liquor and beer. The industry argues that the tax won't only affect those who can afford to pay it because jewelry is not a luxury—everyone buys jewelry, they argue.
- Such a tax would harm an already depressed American industry that is competing with foreign imports. A further decline in employment would be seen in an industry which has lost 7,000 jobs over a 10-year period.

Such a tax could hurt the industry if retailers try to avoid collecting a tax, Collado said. "Most watches get discounted anyway. If a tax is put on $1,000 items an $1,100 watch suddenly becomes $999. One can discount and get under the limit."

Industry members express anger over the fact that the tax seems to be one that aims at the rich, when it really would affect all types of consumers. "It's a populist symbol...Let's soak the rich," said Collado. "Tell me if a $100 watch is a luxury. All watches tell time. When do you decide when it becomes a luxury?"

Indeed, Moshe Pereg, president, Jewelry Manufacturers Guild, in a letter to Robert Leonard, the chief tax counsel of the House Ways and Means Committee, said jewelry is not a luxury when it comes to socio-cultural events such as weddings. In that way, Pereg argued, the tax will affect the low-to-medium-income consumer, while a wealthy person could travel out of the country to buy jewelry, further upsetting the trade balance.

To Yield 1% of Target

Like other industry members, Pereg notes that the revenues from such a tax would only raise one percent of the committee's target by fiscal year 1988.

Meanwhile, Collado has the support of about 50 other organizations, including the American Gem Trade Association and a writing-instruments organization, giving him the clout of about 20,000 companies.

One of the most frequently expressed fears by industry members is that such a tax would exist indefinitely. In his testimony, Leeds said the luxury excise tax levied on jewelry in the early 1940s was not repealed until June 1965, long after the need for the tax disappeared.

The tax was levied to raise revenue for the war effort in World War II. Two years after the tax levied on jewelry, furs, luggage and cosmetics, it was raised from 10 percent to 20 percent. Although Congress had proposed lifting the levy after 1946, it passed a law to keep the tax, one industry member recalled. Finally, in 1965, the industry was successful in getting the tax repealed through expensive lobbying.

In 1982, Congress considered a jewelry excise tax as an option to raise revenues. The Jewelry Industry Committee submitted a petition. However, Congress broke for recess and never considered the option when it reconvened.

Industry members are expected to appear next before the Senate Finance Committee. Bill Osterman, president, Osterman Jewelers, a 52-store chain in Sylvania, Ohio, and a JA board member, is scheduled to testify on behalf of the industry.

StanLee
CORPORATION
Importers · Fine Cultured Pearls... Manufacturers · 14KT Fashion Jewelry
362-1 World Trade Center P.O. Box 580297 Dallas, Texas 75258-0297 (214) 747-2400 TELEX: 293272 STAN UR

July 17, 1987

House Committee On Ways and Means
U. S. House of Representatives
1102 Longworth Office Building
Washington, D. C. 20515

Gentlemen:

We strongly urge you to consider our opposition to an excise tax on jewelry. It will not reduce the Federal deficit. It will drive more business underground. Please reconsider.

Sincerely,

David J. Orman

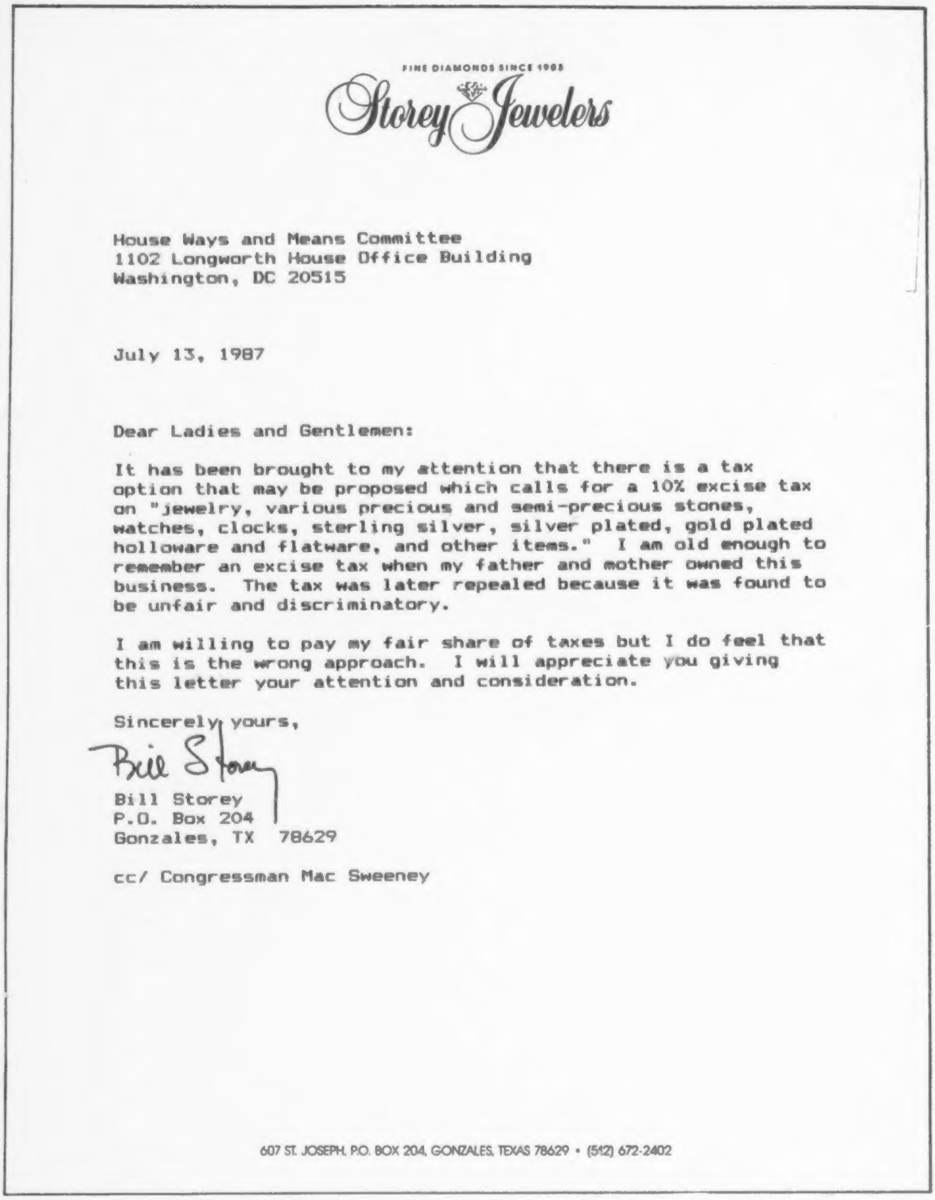
David J. Orman
President

New York, N.Y. *Tokyo, Japan* *Arezzo, Italy*

Jewelry Manufacturers Guild
Jewelers Board of Trade
Jewelry Industry Council

Members:
Cultured Pearl Association of America

The Jewelry Institute
Jewelers Security Alliance
Jewelers Vigilance Committee



FINE DIAMONDS SINCE 1903
Storey Jewelers

House Ways and Means Committee
1102 Longworth House Office Building
Washington, DC 20515

July 13, 1987

Dear Ladies and Gentlemen:

It has been brought to my attention that there is a tax option that may be proposed which calls for a 10% excise tax on "jewelry, various precious and semi-precious stones, watches, clocks, sterling silver, silver plated, gold plated holloware and flatware, and other items." I am old enough to remember an excise tax when my father and mother owned this business. The tax was later repealed because it was found to be unfair and discriminatory.

I am willing to pay my fair share of taxes but I do feel that this is the wrong approach. I will appreciate you giving this letter your attention and consideration.

Sincerely yours,

Bill Storey

Bill Storey
P.O. Box 204
Gonzales, TX 78629

cc/ Congressman Mac Sweeney

607 ST. JOSEPH, P.O. BOX 204, GONZALES, TEXAS 78629 • (512) 672-2402

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PHIL WHITSON
INVENTORY COMPTROLLER

17 July 1987

The Honorable Dan Rostenkowski
House Committee Chairman
House Committee on Ways and Means
2111 Rayburn Office Building
Washington, DC 20515

Dear Representative Rostenkowski:

This letter is to express our opposition to the proposed 10% Federal excise tax on jewelry and related items being considered by the House Committee on Ways and Means.

From our two previous experiences with such a tax -- during World Wars I and II -- we know that the retail jewelry industry, because of that tax, was denied a fair share of the economic expansion enjoyed by other industries in subsequent years.

As a matter of fact, at the time Congress repealed the last selective excise tax on jewelry in 1965, the Ways and Means Committee noted that such taxes were a source of undesirable discrimination:

> These selective excise taxes tend to reduce sales and therefore reduce income and jobs and industries that produce the taxed goods. In these ways, selective excise taxation results in arbitrary and undesirable distortion in allocation of resources and in this manner interferes with the free play of our competitive market.

With the domestic jewelry manufacturing industry currently facing attack from emerging Far Eastern production centers including Hong Kong and Thailand, as well as continuing European competition such as Italy, such a tax would only serve to worsen an already difficult situation.

Above and beyond this tax placing us at an economic disadvantage in the marketplace, history has also shown that it would be extremely burdensome to the small businessman, costly to administer, and would lend itself to enforcement and collection problems.

Taking all these proven negative aspects into consideration, Representative Rostenkowski, and balancing them against a very tentative revenue return, we hope that you will join with us in opposing the enactment of a selective excise tax on jewelry and related items.

Sincerely,

Matthew G. Stuller
President

MGS/sdm

TOURNEAU

August 21, 1987

The Honorable Dan Rostenkowski, III
Chairman
Committee on Ways and Means
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Hon. Rostenkowski:

We feel that the Luxury Excise Tax Bill is unfair and unwarranted.

An excise tax on jewelry would raise a relatively small amount of revenue. In fact, the 1987 Joint Committee Staff Report estimates that a 10% tax on jewelry over $100 in value would raise only $200 million in 1988. This would meet only one percent of the Ways and Means Committee's 1988 revenue target.

Any excise tax on jewelry would be very burdensome and costly to administer, both for small business and the government. Even a tax on items over $100 would need to be collected on literally millions of transactions at several hundred thousand retail outlets, many of which are mom-and-pop stores.

An excise tax on jewelry, and not all consumer products would be unfair and discriminatory. A $101 watch cannot fairly be described as a luxury item. Indeed, in today's world, most people find watches to be a necessity. Certainly, items like imported caviar, silk scarves, English shoes and designer dresses are more luxury items than most reasonably priced jewelry.

It is precisely because of the burden, inefficiency and discriminatory nature of a jewelry excise tax that Congress repealed it in 1965. The Congress should not take two steps backward and reinstitute it at the expense of particular industries.

Thank you for your consideration.

Cordially,

TOURNEAU, INC.

Jack K. Greiff
Vice President

JKG:sb

cc: Mr. Charles B. Rangel, NY
Mr. Thomas J. Downey, NY
Mr. Raymond J. McGrath, NY

500 Madison Avenue at 52nd Street / New York, N.Y. 10022 / PL 8-3265-6

town & country

jewelry manufacturing corp. 25 union street, chelsea, massachusetts 02150
telephone 617 - 884-8800 *telex 940686*

August 27, 1987

Robert J. Leonard, Esq.
Chief Tax Counsel
Committee on Ways & Means
U.S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Leonard:

I understand that the Committee recently considered a proposal to impose a luxury excise tax on jewelry and related items, and that the proposal was discussed at hearings held last July 7 through 9.

My company, Town & Country Jewelry Mfg. Corporation, is in the business of manufacturing and distributing fine gold and precious stone jewelry at the wholesale level. It is obvious that such a tax would have a significant negative impact on this company and on the American jewelry industry as a whole. While I am sure that each tax proposal which comes before the Committee brings with it an onslaught of correspondence of the 'Oh please guys, not my industry' nature, I do ask that you consider the following as you formulate the direction which the new revenue raising proposal will take.

The Industry

The American jewelry industry comprises a vast number of small to mid-size companies. It is not characterized by large conglomerates or vertically integrated giants. For the most part, this industry functions in a fairly "pure" market. Cost of entry is not prohibitively high, and competition abounds. The retail consumption of our products is very elastic in nature; the purchase of jewelry will be postponed or down-scaled fairly readily during times of recession or other financial uncertainty.

Similarly, a rise or fall in the cost of materials will have a significant impact on sales volume. Demand will fall as prices increase. Gold is an important component which affects the price of jewelry articles, and because of its dual nature as both a financial vehicle and a decorative material, its price is determined by political and economic events beyond the normal rules of supply and demand. The jewelry industry must cope on a daily basis with fluctuations in the price of this volatile commodity.

The Consumer
The American consumer of jewelry is buying articles of personal adornment which are often affilated with an important personal event or celebration. A purchase of jewelry is considered an investment of sorts, and the item is expected to last and be enjoyed for a long time. Wedding and engagement rings are intended to be worn for life. Consumers do not buy jewelry casually, and the emotional investment in a purchase of jewelry is as great for those at the lower end of the income spectrum as it is for the wealthy.

The Excise Tax
Excise taxes are imposed by the federal government on relatively few items at present. Some of these taxes are collected to fund related projects, such as the tax on gasoline which is used to enhance the nation's highway system. Such taxes are perceived as being reinvested in services useful to the taxpaying consumer. Other taxes, such as those on tobacco and alcohol, have an overtone of social policy implementation, and are palatable to the general public because they are perceived as limiting excess in the consumption of potentially damaging substances, which also carry with them certain social costs.

A tax on luxury items will not be so acceptable to the American public. The tax expenditure will not be perceived as providing any directly related benefit to the consumer of luxury goods. Where the tax on gas funds highways and bridges, the tax on jewelry will not result in any distinguishable positive outcome for the taxpayer. And the taxpayer will find it distasteful that the government is surtaxing him on certain purchases which it, in its infinite wisdom, defines as luxury items. No social policy is enhanced, for the consumption of a watch or ring does not carry with it overtones of increased national health and safety costs, as do alcohol and tobacco consumption. The government will be in the business of affecting purchasing decisions, and the consumer will have to deal with an economy in which some purchases are less favored by the government than others.

A Regressive Tax
An excise tax is, by its very nature, regressive. A $100 purchase for a person whose income is $25,000 per year is not equivalent to a $1,000 purchase by a person with $250,000 per year. The person with the lower income is much more painfully aware of the outflow of funds than the wealthier individual, even though the expenditure looks proportionally the same.

Accordingly, the tax will have an unfairly punitive effect on those with less income. These people will find that "luxury" goods are priced even farther out of their reach than ever. The more affluent will reduce their consumption of luxury goods by some amount, and perhaps be more inclined to purchase items in overseas markets, but they will not feel the level of financial constraint that the less affluent will feel.

The effect on the jewelry industry

There can be no doubt that the effect of an excise tax will be a lessening of demand for those goods which are taxed. In implementing this tax then, Congress must select certain industries which it will deny the untrammeled opportunity to grow and prosper which it accords to other industries. This does not enhance social policy, it simply raises revenues. Congress, with its collective intelligence and concern for the well-being of American industry, must certainly be able to contrive a better way of raising revenue than to burden an unfortunate few producers and retailers with market constraints and the administative burdens that accompany tax compliance.

American industry was a net loser in the recent 1986 tax reform legislation. The sweet song of lower rates does not obscure the fact that inclusion of income has been accelerated dramatically, and compliance technicalities have risen to nightmarish complexity. We have had to cope with almost yearly changes in the tax code for some time now. The changes and their potential retroactivity has had the effect of paralyzing the business decision process in many a company. To impose this new tax, although ostensibly on consumers, would truly be unfairly burdensome.

On behalf of the jewelry industry in particular, and the "luxury" goods industry of which we are a part, I urge you to remeove this excise tax from your list of potential revenue raisers. This tax would be regressive, administratively burdensome, unfairly punitive to a small, but highly competitive, sector of the American marketplace, and would put Congress in the politically unattractive business of distinguishing luxuries from non-luxuries.

Very truly yours,

C. William Carey

C. William Carey
President

UPPER-LEVEL, INC.
HOUSE OF NOSTALGIA
111 WEST MAIN - MINI-MALL
TAYLORVILLE, ILLINOIS 62568
Phone (217) 824-4331

August 28, 1987

Senator Dan Rostenkowski
Chairman House Ways & Means Comm.
2111 Rayburn House Office Bldg.
Washington, D.C. 20515

Dear Senator:

From recent trade journals and a number of media reports the House Ways and Means Committee may propose a 10% luxury tax on jewelry.

I would like to voice my desent should this tax come under consideration.

The jewelry business as a whole is a very small percentage of this nations economy. Outside of approximately ten major retail chains left in our industry, the industry consists of small family owned and operated stores.

I recall what the 20% luxury tax did to us in World War II and how long it took to rid us of that burden. During that era many sales were squashed by that tax and in almost every sale made the jeweler was asked by the consumer to absorb all or a portion of that tax. Many of them did as a salvation tact. However, it would be impossible with the overhead costs we have today being propelled by wages, insurance and lease percentages over the past 20 years. A luxury tax will not only hurt the industry by turning off sales but could put a lot of smaller jewelers out of business.

Todays smaller family owned store, for the most part, is an ethical operation built on reputation and fair margins of profit, leaving little or no room for tax absorption.

I am sure the House Ways and Means Committee and all members of congress could be mislead, by the abundance of 50-60 and 70% off sales offered by 3-4 and 5 time mark-up operations to allure the unsuspecting - it may lead some to believe the revenue is there for a tax. It is not, particularily for the small jeweler.

Surely other ways can be found to balance the budget. Cutting government waste alone, would make far more monies for Uncle Sam than proposing a luxury tax.

Sincerely,

Mary Krumsiek

Mary E. Krumsiek, Pres.
Upper Level, Inc.
House of Nostalgia Jewelers

"WHERE FABULOUS BECOMES AFFORDABLE"

Wm. Schneider inc.
MANUFACTURING JEWELERS

16400 N. W. 15th AVENUE
MIAMI, FLORIDA 33169
(305) 625-5171

August 21, 1987

The Honorable Dan Rostenkowsky, Ill
Chairman
Committee on Ways and Means
1102 Longworth House Office Bldg.
Washington, D. C. 20515

Dear Mr. Rostenkowsky:

I cannot strongly enough convey to you the terrible effect an excise tax will have on the jewelry industry.

Having been in this industry for forty years, I have seen the negative effect it had when it was allowed to continue after the Second World War. This tax did more damage to the growth of the jewelry industry than any foreign competition could ever do.

At this time, when our country is gradually moving from manufacturing to a service and technology country, we must do everything we can to preserve the product manufacturing end that is the economic backbone of our country. Any unfair tax directed towards one area of manufacturing is prejudiced and contrary to the concept of our constitution which guarantees equality to all.

Please add my voice to all those who share my opinion, and perhaps combined we can convince you that you must not institute an unfair tax on the jewelry industry.

Thank you.

Sincerely,

Jack W. Reiff,
President

JWR/ar

961 Bluff Road
Glncoe, Ill. 60022
August 20, 1987

Rep. Dan Rostenkowski, Chairman
Committee on Ways and Means
1102 Longworth House office Bldg.
Washington, DC. 20515

Dear Mr. Rostenkowski

It has come to my attention that your committee is considering the imposition of a luxury tax. I am writing you to express my strong opposition to such a tax as it is so unfairly discriminatory. If a tax is to be put on jewelry because it is considered a luxury, then wouldn't the same logic put a luxury tax on:

- Any automobile that costs over $10,000?
- Any private swimming pool?
- Any mans suit that costs over $250?
- Any womens dress that costs over $100?
- Any restaurant that charges over $20 for a full meal?
- Any shoes that cost over $75?
- Any boat that is owned for pleasure only?
- Any vacation,or second, dwelling?
- etc.etc.

I am told that your own estimates of additional revenue that might result from a luxury tax on jewelry are only 200 million for 1988, a mere 1% of your committees revenue target. You must also realize that the tax would reduce the sales of jewelry and hence your projected revenue increase. Also, such a tax would not only be a burden, but also costly for both small businesses and government to administer.

Such a tax was repealed in 1965. The reasons it was repealed then are just as valid today.

Sincerely,

Joseph B. Ziegler

A. L. A. Casting Company, Inc.

71 Fifth Avenue, New York, N. Y. 10003
Telephone: (212) 255-2464

Style, Originality
and Service

Aug 20, 1987

Honorable Robert J Leonard
Chief Counsel
Committee on Ways & Means
1102 Longworth House Office Bldg
Washington, D C 20515

Re. Proposed Luxury Excise Tax

Gentlemen
We sincerely feel that this onerous tax is inefficient discriminatory and would place a tremendous burden on our business.

Please use your influence to see that this unfair tax does not pass!

Thank you

Very truly yours,
A L A Casting Co, Inc
Jeffrey Adwar, Pres

Electronic Industries Association

STATEMENT OF THE ELECTRONIC INDUSTRIES ASSOCIATION/ CONSUMER ELECTRONICS GROUP IN OPPOSITION TO AN EXCISE TAX ON CONSUMER ELECTRONICS PRODUCTS BEFORE THE HOUSE WAYS AND MEANS COMMITTEE

The Electronic Industries Association/Consumer Electronics Group (EIA/CEG) has reviewed the description of possible options to increase revenues proposed by the Joint Committee on Taxation and the House Ways and Means Committee. As the national trade group representing manufacturers of consumer electronics products, EIA/CEG asks this Committee to reject the proposed luxury excise tax on items such as TVs, radios, stereo equipment, VCRs, video cameras, and related products.

Excise Taxes on Consumer Electronics Products Are Regressive, and the Consumer Pays the Price

Taxing these items under a 10 percent "luxury tax" rests on a faulty premise - that these consumer electronic products are luxury items. While this once may have been true, it is no longer the case. Radios, TVs, and VCRs are not in the same category as furs, yachts, and personal aircraft. As of June 1987, 98 percent of American households owned a TV, 89 percent had a stereo audio system, and 45 percent had a VCR.

An April 1986 study found that 3 out of 10 households with incomes less than $15,000 are "very likely" to purchase a video product in the next 12 months, and half of all households with incomes less than $25,000 are "very likely" to purchase a video product in the next 12 months. The average household income for the U.S. population is $29,066. Clearly consumer electronics products are not solely being purchased by the wealthy segment of the population.

The National Demographic on Lifestyles (NDL) identified the groups most likely to purchase VCRs. Its findings conclude that affluent and "yuppie" groups have already bought their VCRs, and that the next area of VCR household penetration will be lower income groups. Of all households buying their first VCR in 1986, 14.6 percent had household incomes of under $10,000.

You can pick up any newspaper and find color TVs advertised for $125, VCRs for $150, and radios for much less. As these prices continue to decline, these products can no longer be considered luxury items. As the American lifestyle has changed, expectations of the American people have risen. Radios, TVs and VCRs are as much a part of modern America as refrigerators, books and hair dryers.

Industry Impact

Excise taxes would also impose burdens for the dealers, retailers and distributors of taxable products. The bookkeeping, stocking and staffing needs of such a tax will prove an encumberance on retail establishments by requiring tremendous amounts of detailed record keeping and organization of products. Each of these products has several manufacturers at several different prices. Economic studies demonstrate that these costs will be passed on to the consumer in higher base prices. The result is that consumers become angry at the political system, the retailer and the

2001 Eye Street, N.W. · Washington, D.C. 20006 · (202) 457-4900 · TWX 710-822-0148

manufacturer. Given the fact that consumer electronics are sold through 30,000 U.S. outlets, the ripple effect of this proposal would be enormous.

Educational Impact

TVs, VCRs, and camcorders are used extensively in schools throughout the country at every grade level, including the college and university level. As schools and school districts struggle with budget cuts, an excise tax on consumer electronics products means cutbacks in educational audiovisual aids. EIA/CEG industry figures estimate that for 586,000 scholastic institutions nationwide, including public and private schools, colleges, universities, and trade and vocational schools, approximately 10 million TVs, 3 million VCRs, 13 million audio systems and 300,000 camcorders are currently utilized. The educational community may disagree with the view that audiovisual equipment is a luxury item and would undoubtedly seek exemptions to an excise tax.

Legislative Attempts

Recently, in the state of Hawaii, a bill to place a 4.5 percent tax on televisions, VCRs, and television-related electrical items died because the sponsor and committee chairman had "tested this water" and received negative public reaction in response to the regressive proposal. In Nebraska, a bill which would have placed a 5 percent tax on VCRs, cable television service, prerecorded cassettes and satellite dishes was disapproved in its entirety by the Revenue Committee for much the same reasons. A $2 excise tax on videotape in Toronto, Canada was repealed two months after its enactment because sales decreased dramatically.

Conclusion

Proposals to tax consumer electronics products as luxury items should fail because they improperly target the average, not the affluent, consumer.

We ask that as you examine these revenue enhancement proposals, you delete the inclusion of consumer electronics products in the luxury excise tax context.

FIRESTONE AND PARSON
JEWELERS
THE RITZ-CARLTON HOTEL

BOSTON, MASSACHUSETTS 02117
AREA CODE 617 266-5276
266-1858

August 3, 1987

Robert J. Leonard
Chief Tax Counsel
Committee on Ways & Means
U. S. House of Representatives
1102 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Leonard,

I wish to register the strongest possible objection to a "luxury" tax on jewelry and other related items as described in a Description of Possible Options to Increase Revenues, dated June 25, 1987.

On page 46, under pros and cons, the argument is presented that, properly targeted, "luxury" excise taxes would be more "progressive" since the rich spend more of their disposable income on "luxuries" than the poor. Further, on page 47, the revenue effect is outlined for groups of "luxuries" listed as a through f.

If a "luxury" excise tax is a revenue source the Congress feels might be appropriate then even the most cavalier sense of fairness would require , it seems to me, a tax on all luxuries. Where is it mentioned that a piece of furniture over $1000. is a luxury or any work of art, sculpture, painting, netsuke, etc., etc., over $250. is a luxury. Any house over the average $140,000. must be a luxury, and certainly without question any second house is a luxury. Any private school tuition prior to college must be a luxury. How about first class travel and cosmetic surgery? And vacations over 10 days?

I do not want to continue on with this point, but I am sure you will get the idea that the selectivity the luxury tax exercises,as proposed,is totally unfair and renders the whole proposition without merit.

May I hear from you at your earliest possible convenience.

Very truly yours,

cc: Hon.Dan Rostenkowski
Hon. Barney Frank
Hon. Joseph P. Kennedy

Mark Hurst
POB 417
Englewood, Ohio 45322
10 Aug. 1987

Congressman, Dan Rostenkowski
Ways & Means Comm.
House Office Building
Wash. D. C. 20515

Congressman Rostenkowske:

The control of the purse strings for most of the time since 1933 by you liberals has resulted in our national debt rising from twenty five billion to 2.4 trillion.

The enclosed news clipping & your budget track record indicates you may be in dire need of suggestions from a rank amature.

1. Saving money---Your 25 billion annual welfare to the landed gentry thru the U. S. D. A. needs reducing.

A. Solution---Enact a simple short statute stating, No person or corporation shall receive, directly or indirectly, any benifits from the U. S. D. A. if that person or corporation has a net worth in excess of one hundred thousand dollars.

2. If you really need more tax, enact a luxury tax, we had that during the 1940's.

A. Place a ten percent luxury tax on all non essential merchandise and entertainment, for instance:

(1) Ten % luxury tax on all cars selling for more than $15,000.XX

(2) Ten $ luxury tax on all entertainment. The 200,000 people paying $5.XX to attend the Ohio State Fair yesterday could afford fifty cents to help on our national debt.

(3) Ten % luxury tax on all resturant meals ETC. If they can afford to hire their shopping and cooking chores, they can afford 10% to help on our debt.

(4) Ten % luxury tax on all homes selling for more than $100,000.

Prostitues, gamblers & burglars pay no income tax, the luxury tax would catch some of that money, excepting legalized gambling.

My suggestions are free, you could hire a multi-million dollar commission to study the problem and receive less.

Very Respectfully
Mark Hurst
MARK HURST

PS: The condition of your budget is representated by the color of my ink.

Dayton Daily News and Journal Herald

Monday, Aug. 10, 1987

DAYTON, INC.

Congress' list could hit you in the bank account

WASHINGTON — Tax-raisers on Capitol Hill slashed their 291-page hit list of revenue targets to just 12 items last week.

Three of them could touch you in the wallet, if you own a home or invest in real estate. So you may want to ponder them, or even talk to your congressman about them, during the August congressional recess.

Here's a quick update on the summer saga of Tax Reform, Part II: The Real Estate Nightmare Continues. The plot so far runs like this:

With the blood barely dry from the Tax Reform Act of 1986, House Ways and Means Committee Chairman Dan Rostenkowski (D-Ill.) called on some of the most ingenious minds on Capitol Hill for suggestions about how to raise [illegible] for the federal tax coffers. Rostenkowski had to do so because the Senate and House put him up to it. They'd agreed on a new budget for the upcoming fiscal year that's $19.3 billion more in the red than it's supposed to be. Then they left it to the congressional tax experts — most prominently Rostenkowski and his committee — to get rid of the red.

The chairman turned to the lawyers and economists on the staff of the Joint Tax Committee. They produced the Big List — a compendium of creative revenue-raising options, from new levies on telephones, beer and gas guzzlers to improved methods for squeezing more money out of American taxpayers' heirs.

NATION'S HOUSING

KENNETH HARNEY

Tucked away in the 291 pages delivered by the Joint Tax Committee in June were several proposals affecting homeowners and real-estate investors. Ominously, when the Big List was pared down to the Short List, representing the draft recommendations favored by key staff on the committee, the major real-estate proposals all remained.

■ The most controversial of the three concerns home-equity loans. The Short List didn't specify how the loans could be turned into federal money makers, but the Big List did. Interest deductibility on home-equity loans can simply be cut off, in the words of one staff member, unless the proceeds are used to rehabilitate, acquire or construct a primary or second residence.

As a homeowner, you could still borrow all you want against your house under this recommendation. The only problem is that you couldn't write off your interest payments at tax time, unless the loan dollars went for nothing but the purchase, rehab or new construction of your own house. Few home-equity borrowers currently would pass such a test.

Also outlined in the Big List were home-equity-loan cutbacks on interest deductions beyond $10,000; deductions on home-equity lines of credit with no fixed terms for repayment; and denial of second-home status to boats of any size and mobile homes.

■ The second major item on the Short List of real-estate targets involves tax-deferred exchanging. For years an integral part of many small and large real-estate investors' financial arsenals, tax-deferred exchanging sailed through 1986's legislative bloodbath unscathed. Not so this year, if the revenue-raisers have their way.

Tax-deferred exchanging works like this: If you swap some investment real estate for other real estate of "like kind," you can postpone your federal tax liability until you realize an actual cash gain.

Say that you bought a condo or rental duplex five years ago for $100,000. Now it's worth $200,000. You can swap it, at its appreciated equity value, for a piece of raw land, another condo or whatever form of investment real estate you want, without incurring an immediate tax liability on your apparent profit. Your liability is deferred until you realize a cash profit, by selling the place for money.

Under the draft tax proposal now circulating on Capitol Hill, you'd have a much tougher time qualifying for tax-deferred swaps. For example, you wouldn't be able to exchange your condo for land because the two properties wouldn't be considered "like kind" for federal tax purposes.

■ The final major real-estate item on the hit list concerns investments in a form of publicly traded, stock exchange-listed partnerships known as master limited partnerships. MLPs represent a way to avoid the double taxation typical in corporations. Almost by definition, that avoidance puts them in the revenue-raisers' gunsights.

Where's the Tax Reform-Part II saga headed? Nowhere until September, when Congress returns to confront its own red ink and begins scrambling for quick fixes to cut the flow.

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Communications

Statement of the

National Association of Photographic Manufacturers, Inc.

The National Association of Photographic Manufacturers, Inc. wishes to go on record in opposition to the proposal to place luxury excise taxes on photographic cameras, lenses, film, film projectors, video cameras and recording tape. The proposal was contained in the pamphlet entitled "Description of Possible Options to Increase Revenues Prepared for the Committee on Ways and Means," dated June 25, 1987 prepared by the staffs of the Joint Committee on Taxation and the Committee on Ways and Means.

NAPM is a voluntary trade association composed of companies which manufacture photographic and image technology equipment and supplies. On the equipment side they manufacture cameras, lenses and projectors; on the supply side they make photographic film, video and audio tape, photographic paper and photographic chemicals. Members include such companies as Agfa, Eastman Kodak, Du Pont, Fuji, Ilford, Konica, 3M, Peerless, Polaroid, Powers and others. Our members account for over 90 percent of the photographic products shipped to the United States market.

NAPM is opposed to the imposition of a luxury excise tax when the defined products include cameras, lenses, film, projectors, video cameras and recording tape. It appears from the pamphlet prepared by the staffs of the Joint Committee on Taxation and the Committee on Ways and Means that the above products were included as possible proposals for ad valorem excise taxes because such a tax had been imposed before. The Excise Tax Reduction Act of 1965 repealed these taxes.

NAPM was very active in working for that repeal. Our arguments then and our arguments now are the same. Photographic goods are not luxury items and should not be subjected to excise taxes. The definition of luxury includes the following: "An elegant appointment or material aid to the achievement of luxury; a nonessential item or service that contributes to luxurious living." We have some data on when United States households take photographs.[1] During the holiday season of Christmas and Chanukah, 88% of U. S. households take pictures to record the festivities. At birthdays approximately 79.2% of American homes take snapshots. We believe that picture taking at the above occasions in this day and age are not luxuries, but are necessaries to record the memories and enhance family life.

We also have demographic studies that indicate that people of very modest means purchase cameras and film.[1] The information indicates that the percentage of total U. S. households owning still cameras in the following income brackets are: annual income under $10,000 - 21%; $10,000-$19,999 - 24%; $20,000-$29,999 - 20%; $30,000 and up - 35%. The percentage of families owning any type of camera is 86.2%.

Photographic cameras, especially 35mm single lens reflex cameras commonly referred to as SLRs, are used not only by amateurs but by professional photographers, medical photographers, dentists, orthodontists, forensic and law enforcement experts, photojournalists, governmental photographers and in education and training situations. These cameras have traveled to the ocean's depths and to the far reaches of outer space with side trips to the moon.

Similarly, nonluxury uses for video cameras in many of the above situations and in production quality control and surveillance activities are common everyday occurrences. The film and tape used by the above equipment should also fall into a nonluxury category.

There also is a crossover in the use of film projectors by both professionals and consumers. In the field of education and training, for example, 16mm film projectors account for over 90 percent of sales made to industrial, educational and governmental agencies. In the photographic industry approximately one third of total sales are made to amateur consumers.

It is very difficult to distinguish at times whether an amateur or a professional user is buying the product. 35mm cameras, video cameras, tape, film and projectors can be used by both. Excise taxes, especially levied at the manufacturer's level, are hidden and discriminate against the users and producers of these products. They are inflationary and are basically unfair and a bad idea for raising revenue.

Excise taxes in the photographic industry may well reduce sales and therefore jobs in our industry. The Department of Commerce data in the 1987 Industrial Outlook indicate that the number of jobs in the photographic industry declined two percent in 1986 to 100,000.[2] The number of production workers, about half the total, dropped four percent. Employment has declined for four consecutive years and has reached its lowest level since 1975. We predict that if a ten percent ad valorem tax is imposed on photographic products, this trend will accelerate. None of us would like to see that outcome.

We see a large administrative burden in collecting such a tax, be it at the manufacturers or retail level. In the photographic industry our products can be sold at any of the following outlets: drugstore, supermarket, discount store, department store, camera store, electronics store, chain store, min-lab (drive-in), mail order, and catalog showrooms.[3] As mentioned earlier, it is often difficult to distinguish between a consumer and a professional purchaser.

In summary, photographic products should not be considered a luxury item. People of relatively modest means purchase and use the products of our industry. Excise taxes at the manufacturers level are hidden taxes, are discriminatory, unfair and inflationary. The imposition of the excise tax will adversely affect sales and eventually reduce employment, which is already trending down in the photographic industry.

The administrative burden of collecting such a tax is large, especially if you are dealing in a situation where the amateur and consumer use is very difficult to distinguish from the professional and commercial use.

Excise taxes in this area were recognized by Congress over twenty-two years ago as not such a good idea and were abolished. The passage of time has not invalidated that action. We urge you not to reimpose "luxury excise taxes" on the products of the photographic industry.

We appreciate the opportunity to comment upon this proposal and look forward to an outcome favorable to U. S. consumers. We stand ready to answer any questions that might be raised by our statement.

REFERENCES

1. 1986-87 Wolfman Report on the Photographic and Imaging Industry in the United States, 825 Seventh Avenue, New York, New York 10019

2. 1987 U. S. Industrial Outlook, U. S. Department of Commerce/ Industrial Trade Administration

3. The PMA Industry Trends Report, 1986, Photo Marketing Association International, 3000 Picture Place, Jackson, Michigan 49201

Thomas J. Dufficy, Esq.
Executive Vice President
National Association of
Photographic Manufacturers, Inc.

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The Association for Manufacturers of Image Technology Products

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